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**Accounting for goodwill and intangible assets in the United Kingdom : an analysis using structuration theory**

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**ACCOUNTING FOR GOODWILL AND INTANGIBLE ASSETS IN THE  
UNITED KINGDOM: AN ANALYSIS USING STRUCTURATION THEORY**

**Anthony Andrew Roderick TOLLINGTON**

**A thesis submitted for the degree of Doctor of Philosophy**

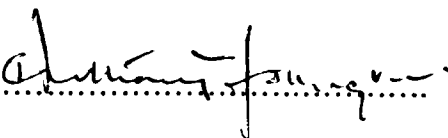
**Kings College London (Management Centre)**

**University of London**

**2005**



**Declaration:** I declare that this thesis is my own research and contains as its main content work which has not previously been submitted for a degree at any tertiary institution.

A.A.R. Tollington.......... Date.....2<sup>nd</sup> March 2005.....

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## ABSTRACT

Structuration theory, explicated in the context of accounting for goodwill and intangible assets, is used in this thesis for the purpose of answering the following research question: How is the Accounting Standards Board able to legitimately construct and perpetuate a portrayal of financial reality that currently includes 'purchased' goodwill and, at the same time, excludes many intangible assets in opposition to those parties, inside and outside the accounting domain, who argue the case for their inclusion on the balance sheet?

Using Giddens's structuration theory, the social structure in respect of accounting for goodwill and intangible assets and the social action of respondents to that structure, as drawn from the Accounting Standards Board's (ASB) consultation process leading up to the implementation of FRS10 on Goodwill and Intangible Assets, is explicated. The interaction of social structure and social action is conducted at the levels of signification, legitimation and domination. The linkage between the *signification* structure and the communication of meaning in the accounting disclosure of goodwill and intangible assets is determined by interpretive schemes of which the reliability of transactions-based measurement is the principal feature. The linkage between the *legitimation* structure and the sanctioning of social action is determined by norms of behaviour of which the moral obligations to act in the public interest, to act professionally, to rationalise practice according to a conceptual schema and to ensure regulatory compliance are the principle features. The linkage between the *domination* structure and the power to affect social action, by the ASB and respondents alike, is determined by the use of resources of which the use of authoritative resources is the principal feature. The analysis reveals a crisis of domination, that is, one in which the opposing consensus-based views of the respondents were selectively overridden by the Board in its construction of financial reality.



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## **Chapter One: Introduction**

### **1.1 The research focus**

For accountants, financial reality is a socially constructed one in which definitions and rules tend to dominate in practice. These definitions and rules establish boundaries as to what will or will not count for accounting purposes, also, the way in which an item within a boundary will be accounted for:

“Organisational researchers have endless theoretical debates on what the boundaries are or whether there are any: the accountants settle the matter by definition, and acquiring boundaries means, for an organisation, acquiring reality” (Meyer, 1983, p236).

It is important for practitioners to follow the definitions and rules of accounting so that their ontological security is grounded on a collective stance even if the conceptual stance is, at times, found to be wanting. Thus, for example, a change in the asset status of purchased goodwill brought about by a change in the rules is a legitimately revised social construction even though, conceptually, the change from non-asset (pre-FRS10) to asset status (post-FRS10) may appear, in principle, to be nonsensical (ASB, 1997, p13). This ‘rules versus principles’ dilemma is used by those who seek to initiate change, the logic being that if one can undermine the principles then this might lead to a change in the definitions and rules of accounting. It is a problematic basis on which to conduct research because the natural inclination of most collectives is towards maintaining the status quo if only, in the case of the accounting profession, for the sake of maintaining consistency of practice and comparability between accounts. Nevertheless, this thesis is concerned with explicating and critically analysing the principles (including definitions) and rules guiding professional accounting practice with particular emphasis on accounting for goodwill.

An interesting feature of Financial Reporting Standard No.10 on *Goodwill and Intangible Assets* or FRS10 (FRS10) (ASB, 1997) was that the capitalisation of purchased goodwill,

instead of the previous write-off policy under SSAP22 (ASC, 1989b), was not founded on the definition of an asset. In other words, the principles (in this case, the definition of an asset) and the revised rules regarding the capitalisation of purchased goodwill were disconnected from each other such that the newly found asset status of purchased goodwill passed into accounting constructed reality with very little conceptual debate. For example, at the public hearings into *Goodwill and Intangible Assets*, Mr Hinton, an Accounting Standards Board (ASB) board member, commented on the lack of conceptual support for the asset status of goodwill in the following terms:

“In fact, the submissions to both the ASC and the ASB have been very, very light on identifying what we actually have in goodwill” (ASB, 1995y, p88).

The asset status of purchased goodwill should ideally be secured by reference to the UK accounting definition of an asset, that is

“Assets are rights or other access to future economic benefits controlled by an entity resulting from past transactions or events (ASB, 1999, p50).”

The definition of an asset comprises an economic perspective, that is, “future economic benefits”, the recognition of which is triggered by a predominantly legal requirement for these benefits to be the result of “past transactions or events”. In addition to the economic and legal perspectives, this definition is set within a conceptual framework, the *Statement of Principles* (ASB, 1999), which contains socio-political policy choices. So, for example, the political decision to use mixed measurement bases in accounting, such as current values and historical cost, is allowable providing any measurement is initially grounded on “transactions”, above (ASB, 1999, p79). Mixed measurement bases are also compatible with the term “future economic benefits”, above, because the definition of an asset does not specify how these benefits are to be measured. The effect, as evidenced in part by this root definition of accounting, is that the accounting picture of financial reality is always an

incomplete one born of the above conceptual eclecticism - legal, economic, social and political disciplines.

The fact that the accounting picture of financial reality is always an incomplete one was not lost on the US Financial Accounting Standards Board (FASB) in their pursuit of a conceptual framework for accounting in the 1980's. What accountants should determine is how much distortion in the picture is acceptable particularly, if one believes intangible assets are of increasing importance:

“The financial statements of a business enterprise can be thought of as a representation of the resources and obligations of an enterprise and the financial flows into, out of, and within the enterprise...Just as a distorting mirror reflects a warped image of the person standing in front of it or just as an inexpensive loudspeaker fails to reproduce faithfully the sound that went into the microphone or onto the phonograph records, so a bad model gives a distorted representation of the system that it models. The question that accountants must face continually is how much distortion is acceptable”. (FASB, 1980, para76)

The explication of the existing definitions and rules of accounting will be supported by the views of respondents to the consultation process leading up to the implementation of FRS10 on *Goodwill and Intangible Assets* (ASB, 1997). Some of the views expressed may be viewed historically – see, for example, Nobes (1992) for a political history of goodwill in the UK in relation to the pronouncements of the Accounting Standards Committee (ASC). More recently, the debate may be viewed in the light of the pronouncements by the ASC's successor body, the Accounting Standards Board (the ASB or the Board). The latest debate could be said to have commenced by the Board with a discussion paper (ASB, 1993), then to a working paper in 1995 (ASB, 1995a) with related public hearings for the first time in the ASB's short history. The process moved on to an exposure draft (ASB, 1996a) and finally culminated in Financial Reporting Standard No.10 (FRS10)(ASB, 1997). The voluminous invited responses to these documents (ASB, 1994a, 1995c, 1996b) and the public hearings (ASB, 1995x,y,z) are testimony to a complex consultation process.

This thesis presents a comprehensive assessment of the above consultation process including some of those issues falling outside the boundary created by transactions or events-based asset recognition.

Whilst each respondent to the above consultation process had their own particular philosophy to legitimise their own point of view, there was little attempt by the Board to analyse those philosophies other than in so far as they applied to the Board's own framework for consultation, confirmatory or otherwise. This framework tends to hold as immutable the definitions of the Board. Thus, there is a deeper level of enquiry to be achieved than that initially offered by the Board's assessment of the respondents' viewpoints on the technical accounting approaches to goodwill and intangible assets. This deeper, conceptual level speaks of the interplay between social actor and social structure. In particular, it is possible to cast the process of arriving at the accounting standard in the nature of a power struggle between those social actors outside and inside the accounting domain who seek to change the social structure of the financial accounting and the way in which intangibles are reported. The focus of this thesis is therefore, not only on establishing a thorough understanding of the dynamics of the existing accounting structures, but, also, upon the dynamics which enable the Board to perpetuate those same accounting structures sometimes in the face of a substantial amount of opposition to them. A key element of those structures is the definition of an asset and its impact upon the disclosure of intangible asset in the financial statements, most notably, to repeat, in the allowance of asset measurement as a substitute for asset recognition. In response to this situation the following general and specific research questions are posed:

*How did the Accounting Standards Board resolve the conflicting views of the respondents to the Board's standard-setting consultation process prior to producing FRS10?. In*



*particular, how did the Accounting Standards Board construct and perpetuate a portrayal of financial reality that currently includes 'purchased' goodwill and, at the same time, excludes many other intangible assets in opposition to those respondents who argued the case for their inclusion on the balance sheet?*

In considering these questions, the submission documents of the respondents to the ASB's consultation process will be addressed for the period 1993-1997, together with the Board's own papers and the general literature in this area of research

.

A common strategy amongst those parties advancing the case for a change to the existing accounting construction of financial reality in respect of intangibles is to point to the growing gap between accounting book values and market values. The debate is typically focused on the resultant information deficiencies with supporting exhortations towards a greater use of valuations-based accounting methods to remedy this situation. In contrast, the debate is rather weak in securing reasons as to why the profession nevertheless seeks to maintain the existing social structures of accounting and is able, despite such exhortations, to successfully resist demands for change. As Lev (2001, p17) argues

“Generally missing from these claims concerning information deficiencies and the suggested remedies are two important elements: a thorough examination of the reasons for the information deficiencies and a careful empirical documentation of the adverse private and social consequences or failures due to the presumed deficiencies. Why is it that, despite the growing awareness of the importance of intangible assets, they remain almost universally ignored in accounting and reporting procedures? Obviously, any useful prescriptions concerning intangibles-related information require a thorough understanding of the impediments to change.”

In posing the above research question it is implied that the “thorough understanding of the impediments to change” will lie in the socially constructed nature of accounting itself and the manner in which that structure is promulgated and protected.

The above central research question refers to the interaction of social structure and social action. The dynamics of this interaction may be analysed by two sub-questions, which collectively comprise the central research question. First, if the Board is “...*able to legitimately construct and perpetuate a portrayal of financial reality that currently includes ‘purchased’ goodwill and, at the same time, excludes many intangible assets...*” then this requires an explication of the existing social structure of accounting for intangible assets (a signification structure). Second, if the Board is able to construct its version of financial reality “...*in opposition to those parties, inside and outside the accounting domain, who argue the case for their inclusion on the balance sheet*” then it clearly has the power to do so as derived from some structural basis in society (a domination structure). The accounting construction of financial reality and the power to enforce it is brought about by the profession’s pre-eminent role in financial reporting. But that role only exists because society decrees that it should do so based upon the expectation that accountants will act in the public interest, that they will act professionally, that they have the means to regulate and enforce their version of financial reality (a legitimation structure). It is for these reasons that Anthony Giddens’s (1976,1979,1984,1987) structuration theory with its emphasis on the social structures of signification, legitimation and domination has been chosen as the appropriate research approach to address the central research question.

Let us briefly review the three structural dimensions of Giddens’s structuration theory. They are developed further in chapter three.

The signification structure is a socially created accounting structure that is drawn upon by social actors in social interaction. It is the medium which, in this context, social actors use

to bring themselves understanding on the subject of accounting for goodwill and intangible assets. At the same time, their interaction with it both reinforces that structure and also provides the possibility of change to it. For it is in the nature of the interplay between social structure and social actor that there is always the possibility of change particularly where this is politically motivated. Typically though, social structure is reproduced through repeated compliance in practice with the rules of accounting as social actors apply their cognitive skills to structure and make sense of what others do. Part of a formal training in accounting can be said to inculcate into the minds of social actors a particular way of seeing and interpreting which, in the context of intangibles, is centred upon maintaining the reliability of measurement afforded by a transactions-based measurement system.

The legitimation structure presents the accepted norms and moral codes of behaviour which actors draw upon in social interaction. These accepted norms and moral codes of behaviour define the mutual rights and obligations of actors across a wide range of social settings. It is possible to examine the accepted norms of behaviour within the narrow context of the consultation process leading up to the implementation of FRS10. In a broader context, the norms of behaviour for accounting actors are mediated, for example, by overarching policy documents, such as the *Statement of Principles* (ASB, 1999), as well as the codes of behaviour of various professional and institutional structures. Both contexts are to be addressed in this thesis.

The norms of accounting behaviour (legitimation) and the interpretive rules of accounting (signification) are manifest in the use of allocative and authoritative resources, the resources of a domination structure. In the context of goodwill and intangible assets it is

the authoritative resources of the Board that are pertinent here. The expected norms of behaviour and expected manner in which interpretive schemes will be applied in practice place obligations upon social actors that may also result in the threat of sanctions for non-compliance. These obligations legitimise the exercise of power by the institutions of accounting, for example, through the threat of audit sanctions and the rulings of the Financial Reporting Review Panel. However, it is important to comprehend that the exercise of power is not unidirectional with agents capable of acting purposively to reinforce or to modify social structures. Both capabilities will be explored in this thesis principally from a critical perspective though there will be interpretive elements as well. That exploration is structured as follows.

## **1.2. Outline of the chapters**

Chapter two positions this research within the literature. A substantial amount of the identified literature is directed towards three themes:

- the merit of various goodwill and intangible asset accounting methods
- the various motivations for adopting these accounting methods
- the growth and financial market effects of goodwill and intangible assets

The important feature of these themes is, again, that they take the accounting existence of purchased goodwill for granted as a measured “difference”. That measured difference may be written-off (ASC, 1989b) or capitalised (ASB, 1997) without reference to its status as an asset, or not. Thus, much of the literature is directed towards the justification for the selection of appropriate accounting methods rather than to such conceptually based concerns. In other words, the existing accounting structure remains unchallenged despite the fact that the specific issue of goodwill and intangible assets appears to highlight weaknesses within this structure. This thesis clarifies and challenges those socially constructed structures.

Chapter three presents the research method. First, Laughlin's (1995) Theory, Methodology and Change Matrix is used to establish the philosophical underpinning to the research approach: a Kantian/Fichtean philosophy. The philosophical underpinning assumes a world where there is no basis upon which to judge the superiority of one interpretation over another and, therefore, any attempt to do so can only be advanced and subjectively justified on the basis that it produces a 'better' socially constructed view of reality. The existing social construction in respect of goodwill and intangible assets is examined critically. However, it may also be interpreted and reinterpreted in a manner that is unconstrained by the existing social structure. The combination of critical and interpretive approaches is then given methodological rigour through the use of structuration theory.

Chapter four analyses the signification structure of accounting issues surrounding goodwill and intangible assets. In the context of this thesis the signification structure is bound together by the need of accounting actors to ground the accounting recognition of intangible assets on the perceived reliability of measurement afforded by "past transactions or events", in particular, transactions-based cost. Thus, a feature of this structure is the UK accounting definition of an asset (ASB, 1999, p50) and the wide degree of discretion that it allows on what may be regarded as an asset, subject to the "transactions or events" caveat. The other important feature of this structure is the tension within it that is caused by the use of mixed measurements, costs and values, and, as a result, the merging of two mutually exclusive views on the role of the balance sheet.

Chapter five analyses the legitimation structure of the accounting issues surrounding goodwill and intangible assets. The choice of social structure is important, specifically, as

to whether legitimation should be abstracted from a narrow institutional analysis of the consultation process leading up to the implementation of FRS10. Alternatively, whether legitimation should be set in the broader, strategic social setting of the Board's attempt to legitimate its standard setting role in society. In keeping with Scapens and Macintosh's view (1994, p675) that both contexts can be accommodated within structuration theory, this chapter reflects the broader social setting and uses the narrower setting by way of illustration where this is appropriate.

Chapter six analyses the domination structure of the accounting issues surrounding goodwill and intangible assets. It is obviously important that a moral consensus derived from a standard setting consultation process is not undermined by accounting practices that are regarded as being contrary to the established norms of behaviour. Where accounting practices deviate from the norm then they will be addressed in terms of audit censure and through social structures, such as the Financial Reporting Review Panel and the various disciplinary panels of the professional institutes. In the vast majority of cases, the exercise of power in this regard should be unnecessary. This point is to be addressed by way of a longitudinal survey of goodwill and intangible asset accounting practices in order to determine the degree of compliance. However, it is where the practices are pursued through a desire to benefit from accounting arbitrage that the problems arise. Particularly so, where these practices are allowable within the existing signification structure but as minority practices they are, nevertheless, prejudicial to the maintenance of a moral consensus within accounting.

Chapter seven presents a summary and develops some conclusions linking to a future research agenda presented in chapter eight.

## **Chapter two – Positioning this research within the literature**

### **2.0 Introduction**

The purpose of this review is to show how, in general, the literature has a dominant ‘measurement only’ focus to it. The emphasis is upon asset measurement substituting for asset recognition.

Notwithstanding this introductory assertion, section 2.1 attempts to identify the nature of purchased goodwill. There are a small number of rather dated recognition, rather than measurement-based, studies to be found in the literature that seek to explicate the nature of goodwill.

Section 2.2 then takes up the introductory point that the majority of the goodwill and intangible asset studies in the literature start from the basis that the transactions-based measurement “difference” (that *is* the defined nature of purchased goodwill – ASB, 1997, p9) is simultaneously the basis on which goodwill ‘asset’ recognition takes place. The justification for this predominantly ‘measurement only’ accounting stance is based upon the notion of measurement separability (Napier and Power, 1992) and is supported by, what is known as, the ‘value-relevance’ literature from the finance domain.

Section 2.3 looks at the mixed measurement basis, transaction cost and fair value, that results in a defined purchased goodwill “difference” between them at the point of acquisition. Whilst, the emphasis is still upon measurement, section 2.3 explores whether the goodwill “difference” may be recognised as something that has economic substance, as suggested by the value-relevance studies. Three related issues are addressed from the literature: first, the measurement “difference” hides, as yet, unidentifiable intangible

assets, second, the measurement “difference” represents the avoidance of start-up costs, third, the measurement “difference” represents an overpayment to acquire a business.

Section 2.4 addresses the contradiction between the accounting disclosure of a measured goodwill “difference” (and anything extracted from it, such as brands) whilst simultaneously not disclosing their internally generated counterparts. The literature shows that the difference between purchased intangibles and internally generated intangibles, once again, turns on the issue of measurement, not recognition per se. Specifically, internally generated intangibles are measured on the basis of a valuation outside the existing asset recognition boundary posed by the initial requirement for a transactions-based measurement.

The main thrust of section 2.5 involves a return to the ‘value-relevance’ literature to show how the existing ‘measurement only’ approach is unable to distinguish an asset from an expense. Many expenses for accounting purposes are shown to be ‘value relevant’ and, therefore, they exhibit the asset-type characteristic of wealth creation. In other words, the ‘measurement only’ approach espoused in sections 2.2 to 2.4 is flawed because of this demarcation problem. This is important because the recognition of an intangible asset is located at the boundary between an asset and an expense. It is intimated that there is a need for precise asset recognition criteria other than, or in addition to, that currently offered in the UK definition of an asset (ASB, 1999, p50).

Section 2.6 addresses the last point from section 2.5 in respect of asset recognition, notably in respect of the notion of separability – a feature that is missing from the definition of an



asset. This task is undertaken by reference to Tollington's (2002) Separability Initial Recognition Cycle or SIRC diagram.

Section 2.7 extends the 'measurement only' argument presented so far by looking at its impact on the regulatory framework leading up to the implementation of FRS10. If on the basis of some asset recognition criteria rather than asset measurement, purchased goodwill was found to be, or not to be, an asset by nature then this should have preconditioned the choice of accounting method to be regulated into existence. Instead, from the outset of the consultation process leading up to FRS10, respondents were asked to choose between elimination-based or asset-based methods – a preference-based approach, not one based on a determination of asset status. The exercise of preferences in the regulatory process is reviewed in section 2.7, that is, in four subsections 2.7.1 to 2.7.4, which chronologically follow the standard setting process.

Finally, in section 2.8, there is a summary critique of the dominant 'measurement only' stance and a positioning of the contribution of this thesis in the literature.

### **2.1. Recognition of the asset status of purchased goodwill.**

Within the literature the conceptual underpinning to the asset status of intangibles is provided, in part, by a definition of an asset that is focused on measurable outcomes, the "future economic benefits", rather than on the recognition of the source of those outcomes. Some early asset recognition studies exist that attempt to define the nature of goodwill. It is a study that is necessary if one regards the definition and recognition of the nature of an intangible asset as a prerequisite to its measurement. This is clearly problematic in the case of something that is intangible in nature but one that is, nevertheless, pertinent, otherwise,

one cannot be too sure about what one is measuring. Nelson (1953, p491), for example, views goodwill as “about as fickle as the human nature of which it is an aspect”. However, he argued that it may comprise customer lists, organisation costs, costs of development, trade marks, trade names and brands, secret processes and formulas, patents, copyrights, licences, franchises and superior earnings. Catlett and Olsen (1968, p18) argued that there is no list of all or nearly all the factors and conditions contributing to goodwill, a fact which is itself indicative of the nature of goodwill. They, nevertheless, list the following goodwill attributes: superior management team, outstanding sales manager or organisation, weak competitor management, effective advertising, secret manufacturing processes, good labour relations, outstanding credit rating, top flight training programs, high standing in the community, favorable company associations, strategic location, discovered talents or resources, favorable tax conditions and favorable government regulation. Tearney (1973, p44/45) argued that the term goodwill is an old term that has outlived its usefulness. It conveys absolutely no information to financial statement users about the underlying assets acquired. He identifies a number of ‘hidden assets’ within goodwill: patents, licences, designs, unique engineering staff, trademarks, high product quality, good customer relations, personnel skills and marketing channels. Finally, Falk and Gordon (1977) identify the following characteristics related to goodwill: Increasing Short Run Cash Flow (cluster A), Stability (cluster B), Human Factor (cluster C) and Exclusiveness (cluster D) which includes access to technology and brand names. A number of goodwill attributes are common to each of the studies. For example, it can be seen that three of the four studies, above, identify brand names/trade marks as a constituent element of goodwill.

It can be seen from these early accounting studies that the authors are, in the main, sceptical about the nature of goodwill but at least, unlike more recent accounting studies,

they were prepared to recognise what they believed to comprise its constituent nature. In more recent years the accountants have settled the issue of purchased goodwill by defining it operationally as a measured “difference” (ASB, 1997, p9). The defined goodwill difference is also consistent with the definition of an asset in that it too is measurement focused, that is, on “future economic benefits” (ASB, 1999, p50). In both cases there is no attempt to recognise the substance of what is to be measured. Rather, the measured goodwill “difference” and the measured “future economic benefits” are, respectively, the basis for asset recognition. To reinforce this linkage of the above definitions, Johnson and Petrone (1998, p296) refer to “core goodwill” (clarified in section 2.3) as an asset because it complies with the definition of an asset in the following manner (underlined):

1. Whilst goodwill is not a separable and exchangeable thing, it may nevertheless contribute towards the creation of future economic benefits. However, the lack of separability makes the acquisition of benefits “...more nebulous and may be less certain than the benefit that is associated with most other assets” (p297).
2. Control over goodwill is provided by ownership of a controlling interest in the business as a whole.
3. Goodwill is the product of a transaction to acquire a business.

Assertions as to the asset status of purchased goodwill in this manner prejudice the use of asset-related accounting methods with capitalisation being the starting point for consideration of an appropriate accounting method. Yet, historically, pre-SSAP22 (ASC, 1989b), there had been considerable variation in how to account for purchased goodwill or what was “left over” from acquiring a business (see Lee, 1971, p318). Lee (1973, p185-186, italics added), for example, recommended:

“Goodwill arising on a business combination should be in the first instance treated as an asset...Goodwill represents purchased resources with *presumed* long-term lives if properly

maintained, and therefore should be accounted for as such...Goodwill, computed and accounted for as above, should not be amortised or written off unless the directors of the company concerned have good reason to do so.”

Lee’s presumed long-life expectancy of a goodwill ‘asset’ should rightly condition the subsequent accounting policy with regard to retention on the balance sheet, but it is only a presumption. No claim is made as to asset status according to asset recognition criteria because they do not exist, nor in relation to the definition of an asset: in the manner of Johnson and Petrone previously. The resultant danger was an accounting policy being driven by preference, preference that is not necessarily preconditioned by the determination of asset status. That was certainly the case in SSAP22 (ASC, 1989b) where both elimination (to reserves) and, paradoxically, capitalisation (plus amortisation) methods were allowed: non-asset and asset status, respectively, within the same accounting standard. Interestingly, Jennings, Robinson, Thompson and Duvall (1996, p514/5), were apparently able to support ‘capitalisation/amortisation’ and ‘capitalisation/impairment reviews’ at the same time, a subsequent feature of FRS10:

“...these findings are consistent with the hypothesis that investors view purchased goodwill as an asset that is expected to decline in value for the average firm in our sample. However, our results also indicate that the relationship between the underlying goodwill asset and its accounting treatment may vary substantially from firm to firm. This suggests that the alternative of allowing firms to capitalize purchased goodwill and to review their goodwill balances annually, if properly implemented, may have the *potential* to best represent the resources and performance of the firm.”

So, whilst the profession is now able to assert the asset status of purchased goodwill from a disclosure viewpoint, there is still variation as to whether amortisation or impairment is the appropriate accounting method to use. The point here is to argue the position that the historic lack of consistency in the exercise of accounting preference is, in part, due to an inability to accurately identify and recognise, other than by measurement, the asset status of goodwill and by extension to any related intangible asset. And, the UK definition of an

asset does not help in that regard. Samuelson (1996, p150), for example, identifies three fundamental attributes of the FASB definition of an asset, which because of the closeness of the UK definition to the US definition are also transferable to a UK setting:

“(1) the term “economic benefits” can be understood either in a financial sense or a non-financial sense, which confuses the definition of assets with the measurement of assets; (2) the definition lacks empirical content because it confuses stocks and flows by defining assets, which are stocks, in terms of future economic benefits, which are events or flows; and (3) the definition emphasizes the economic rather than the legal characteristics of assets, or the benefits of wealth instead of the rights to use wealth.”

Samuelson points out the following respective weaknesses:

First, the object of measurement (the element) should not be confused with the method of measurement (typically, cash flow) (see p151). Second, the stock of wealth comprising an asset should not be interpreted in terms of resources, but in terms of property rights (see p152). A debtor, for example, may not be a resource but it is certainly a right. Third, the definition admits things for which a right to property does not exist, such as deferred costs (see p153). Nevertheless, asset measurement is the principal means of asset recognition.

## **2.2. Intangible asset measurement substituting for intangible asset recognition.**

Let us return to the general UK accounting definition of an asset:

“Assets are rights or other access to future economic benefits controlled by an entity resulting from past transactions or events (ASB, 1999, p50).”

In contrast, the specific UK accounting definition of intangible assets refers to the fact that they are:

“Non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights (ASB, 1997, p8).

A feature of this intangible asset definition is that it is a constitutive definition. It attempts to define what it is by nature. In contrast, the general UK asset definition is not

constitutive, nor operational as a definition. The UK asset definition attempts to define what an asset is by nature (constitutive) but that nature is actually expressed in terms of what an asset does (operational), that is, produce future economic benefits. According to the UK asset definition, for example, advertising expenditure, that is, revenue expenditure not capital expenditure, is an asset because it can produce future economic benefits and is the result of past transactions or events. Of the two definitional types one suspects that the general UK asset definition is more in the nature of an operating definition and therefore it is difficult to reconcile with the constitutive definition of an intangible asset. This situation suggests that the nature of an asset, and the nature of a 'goodwill asset', cannot be fully addressed by an operating definition. Let us consider this issue further.

Without the asset recognition boundary created by "past transactions or events", the general requirement for "rights or other access to future economic benefits" would not prejudice any particular measurement basis, in particular, transactions-based cost. In principle, at the initial recognition stage of an asset, there would be no grounds for the prohibition of independent valuations. Equally, the general requirement for "rights or other access" would not prejudice the accounting recognition of purchased intangible assets over the recognition of 'non-purchased' internally generated intangible assets. It then becomes a matter of how one seeks to exercise "control". In this regard, the reliability of measurement afforded by transactions-based cost appears to be the dominant factor. In effect, if one can measure the intangible asset reliably, de facto one has also recognised it. Thus, within the literature the accounting recognition of intangible assets is on the basis of a reliable measurement despite the fact that asset measurement is logically subsequent to asset recognition.

Of course, this does not appear to ‘sit well’ with the view of an intangible asset having a separately recognisable nature and function from the other assets of a business, for example, according to certain asset recognition criteria. However, it does ‘sit well’ with a measurement only view of separability: where measurement is the means of separable asset recognition - Napier and Power’s (1992) “measurement separability”. There is no precise definition of measurement separability. However, it is defined here as the subsumption of the process of asset identification and recognition within asset measurement such that asset measurement and the reliability thereof become central to accounting policy choices in respect of the separable disclosure of intangible assets.

Napier and Power (1992) argue that measurement separability effectively collapses all three stages of identification, recognition and measurement into one. In other words, if one can measure the resource in an acceptable manner, then it is difficult to resist the identification of the resource as an asset and its consequent recognition in financial statements. The key point here is what is an “acceptable manner.” Napier and Power indicate that transaction-based methods are “acceptable” whilst valuations-based methods, less so. For example, they do not support common brand valuation approaches, such as brand contribution methods, because of the difficulty of separating the earnings of the intangible asset to be valued from the earnings of the other assets. They argue that the whole family of brand contribution methods stands or falls on the issue of whether the use of such residual approaches can in fact dichotomise the economic benefits attributable to a business, business segment or product into those attributable to the intangible and those attributable to other assets or to a baseline unbranded product.

Napier and Power also address an important Arthur Andersen (1992, p90) report, which was largely supportive of brand valuations:

“We have already alluded to an underlying circularity in the description of various valuation methods; such methods are claimed to be acceptable because separate identification is possible, but we argue that such methods determine, rather than depend upon, separability. Because of this apparent circularity, the acceptability of such methods cannot be determined simply by appeals to the idea of separability, because this idea is not independent of measurement.”

As we shall see in section 2.6, the assertion that separability is not independent of measurement is open to challenge. Yet, the related implication remains that valuation-based approaches produce unreliable measurements for accounting purposes when compared to their transactions-based counter-parts. That said, valuation-based approaches (outside the existing accounting structure – notably from the field of finance) are ‘called upon’ to validate the Napier and Power ‘measurement only’ stance towards the accounting recognition of goodwill and other intangible assets (inside the existing accounting structure) in what is generally referred to as the ‘value-relevance’ literature. Let us address that literature next.

The assumption underpinning ‘value-relevance’ studies (see Barth (2000); Holthausen and Watts (2001) for summary overview papers) is that if the expenditure in question has a positive association with earnings returns and share prices then it has a valuable content or economic substance and, therefore, must be an asset. The converse is also held to be true, in which case the expenditure should be expensed to the P&L account. The linkage of asset status to earnings returns and share prices is fundamental. Thus, for example, in Gu and Lev’s (2001) paper the attempt to place a value on intangible assets is earnings related. Specifically, intangible assets are valued on the basis of ‘normalized earnings’ (a weighted average of past and future earnings) from which the earnings returns from physical and



financial assets are deducted to arrive at a residue of earnings said to be in respect of intangible assets. These earnings may then be discounted for capitalisation purposes. The points to note here are that first, intangible assets are recognised on the basis of a measurement, second, that these assets have no separable identity because they are often valued as a bundle of assets. Bundles of assets offer the prospect that mixed in with them are expenses more properly written-off to the P&L account. Finally, that, whilst value-relevance is outside the existing accounting structure centred upon transactions or events, these studies strengthen the case for the 'measurement only' stance presented by measurement separability.

*Establishing a component of value – 'value-relevance'*

Establishing a component of value for goodwill and other intangible assets is therefore supportive of the existing accounting structure – to be addressed in chapter four. Consider the comments of McCarthy and Schneider (1995, p80) who state:

“...that the market tends to view goodwill as an asset when valuing a company. This result is consistent throughout several different models, both full and reduced. The second major finding was that, relative to their book values, goodwill is valued by the market at least as much as other assets.”

The clear implication is that purchased goodwill has value and therefore is an asset: “...as much as other assets”. Archer (ASB, 1994a, p17/18), similarly, asserts the importance of establishing a 'component of value' for purchased goodwill. He said:

“While not an 'asset like any other', purchased goodwill is 'a component of value'. If the excess of consideration given on an acquisition over the fair value of the separable net assets of the acquired firm ('excess cost') is not a component of value for the group, then it represents a loss and should be treated as such.”

The idea of a 'component of value', above, suggests that there may also be other components. For example, Henning, Lewis and Shaw (2000, p375/6) argue that purchased goodwill comprises the following components:

"(1) the write-up of the target firm's assets to fair value...(2) the value of the target as a going concern or stand alone entity...(3) the market's valuation of the synergistic value created by the acquisition...(4) any overvaluation of consideration and/or overpayment for the target..."

The breakdown of goodwill in this fashion draws partly upon Johnson and Petrone's (1998, p295) component parts of goodwill, to be explored in the next section. The point to note here is that, yet again, the approach to goodwill asset recognition is measurement-based. The constituent 'nature' of purchased goodwill, if one exists, is not actually addressed. Indeed, in respect of (2), (3) and (4) above, the measurements appear to be related to the acquisition of a firm as a whole rather than any 'component' of purchased goodwill itself as a separable asset. Thus, the accounting definition of purchased goodwill was taken for granted and all that apparently mattered was establishing a positive value, or not. They concluded (p385):

"Consistent with concerns that some components of goodwill are assets while others are not, our results show that investors attach positive and negative weights to components of goodwill. In particular, both the going-concern component and the synergy component are significantly positively valued by the market, with the going-concern component valued similarly to nongoodwill assets and the synergy component receiving a higher weight...We also find that investors place a significantly negative value on residual goodwill component, which captures amounts in excess of the net increase in market value to the parties to the transaction."

Consistent with the measurement-based approaches to all the papers reviewed so far, a positive market effect supports the assumption as to the asset status of purchased goodwill. The largest influence in this regard was obtained from synergistic gains but the 'how' and 'from what' precisely these gains were obtained was not explained.

The last point from the Henning et al quote, above, is worthy of further attention. They state (p376, brackets added) that they,

“...find no evidence that the market places a continuing value on the residual component of goodwill; in fact, the results show a significant negative association between RESID [residual goodwill] and share price, consistent with the market writing off overpayment in the year of acquisition”.

The concept of a residual component remaining from what is itself a residual figure or, more specifically, a defined “difference” (per SSAP22/FRS10) seems to be a little strange. Henning et al were not alone in this viewpoint, for example, the notable study by Arnold, Egginton, Kirkham, Macve and Peasnell (1992, p21) also identified purchased goodwill as having synergistic type attributes (“present value of benefits arising...from jointness of activities...”) as well as an over/under payment element. Similarly, Higson identified a significant overpayment element to purchased goodwill (see ASB, 1995c, p171). The issue, however, is whether, irrespective of the positive or negative market effects of points (2), (3) and (4), respectively above, these, or any other attribute associated with a defined “difference”, should be recognised as an asset for accounting purposes. Here again, the asset recognition issue is only addressed within the context of asset measurement.

### **2.3 The mixed measurement approach of the existing accounting structures.**

Various measurement bases are sometimes mixed together in accounting to produce “differences” of measurement that may be sometimes separately recognised and disclosed for accounting purposes, as with purchased goodwill. The question then arises as to the constituent nature of this “difference” when, prima facie, all it is by definition and by nature, is a measurement difference caused by the mixed measurement system of accounting as ‘a whole’ (transactions-based) or the ‘sum of its constituent parts’ (fair value-based). This issue is addressed comprehensively in chapter four. Yet, despite this

assertion, consider three attempts at determining the nature of this “difference” from the literature.

*The measurement difference may be ‘hiding’ component elements such as unidentifiable intangible assets.*

The Sciteb Colloquium (ASB, 1994a, p372, brackets added), comprising thirteen Chief Executives, Finance Directors and Managing Directors argued that the measurement of purchased goodwill was an accounting fiction. They commented that the premium paid by a business to acquire another business was due to a combination of the following factors:

- “(a) The book value understates the value to the acquirer of the financial or tangible assets.
- (b) The IA [intangible assets] acquired are valuable to the acquirer.
- (c) Overpayment by the acquirer.”

It would appear that any payment for goodwill is actually, in part, a payment for intangible assets, other than goodwill, and/or any overpayment to acquire a business. In contrast, Arnold, Egginton, Kirkham, Macve and Peasnell (1992, p21) state that goodwill may be decomposed into three parts:

- “(a) The fair value of separately identifiable intangible assets;
- (b) The present value of benefits arising (not reflected in (a)) from jointness of activities and market imperfections such as monopoly position and barriers to entry;
- (c) Over- or under-payment.”

The principal difference between the above two viewpoints lies in the fact that the Arnold et al study introduces the notion of goodwill as a form of synergistic gains. This was also an important feature of Johnson and Petrone’s “core goodwill”.

Johnson and Petrone (1998, p295) identify six component elements of purchased goodwill:

- “1. Excess of fair values over the book values of the acquiree’s net assets...
2. Fair values of other net assets not recognized by the acquiree...
3. Fair value of the “going concern” element of the acquiree’s existing business...

4. Fair value of synergies from combining the acquirer's and acquiree's businesses and net assets...
5. Overvaluation of the consideration paid by the acquirer...
6. Overpayment (or underpayment) by the acquirer..."

Component one is part of the fair value of the acquired net assets and as such is part of those assets rather than constituting a goodwill asset itself. Component two refers to those 'hidden' intangible assets not recognised according to the existing asset recognition criteria. Instead, these intangible assets are grouped together under the generic heading of goodwill. Components one and two are part of the other assets of a business, not a goodwill asset.

Component five refers to errors in valuing the purchase consideration as when, for example, a business is acquired for shares. Component six represents a loss or gain to a business. Components five and six are not part of any asset, including a goodwill asset – they are expenses.

Component three "...might be thought of as pre-existing goodwill that was either internally generated by the acquiree or acquired by it in a previous business combination and may be referred to as "going concern" goodwill." (Johnson and Petrone, 1998, p296) The value of "going concern" goodwill is based on the market value of the company as a stand-alone enterprise. Component four "...did not exist before the combination but rather results from the combination and thus may be referred to as "combination goodwill". The value of that goodwill is based on the excess of the acquisition price paid for the acquiree over its market value as a stand-alone enterprise" (p296). Components three and four are part of a goodwill asset in what Johnson and Petrone call "core goodwill". The point here

is that in both cases asset recognition is on the basis of a mix of measurements: a market value or acquisition price.

*The measurement difference representing the avoidance of start-up costs*

Grinyer (ASB, 1995c, p143-145) offers an interesting view of the nature of purchased goodwill as a premium for the avoidance of risk and a payment for the profit, which would otherwise be lost with the alternative 'self-start' investment option in the early years of a business's development. One could reason (p144)

"...that acquisition is frequently an alternative to 'self-start' investment which would create businesses which possess the characteristics desired by the acquirer. It follows that the acquisition of an established business has saved the acquirer the very substantial costs of getting to the same position by the alternative 'self-start' option. Such savings represent cash based benefits of acquisition, assuming that the acquirer would have proceeded with the alternative investment."

In support of the 'self-start' assertion, Grinyer said that

"...the business has acquired profits during the build up period of the alternative business investment, for new businesses in a competitive environment are rarely profitable during the time of their early development; and the avoidance of the uncertainty associated with a new business..."(p144).

In addition, the acquirer obtains benefits such as those listed in a study by Coopers &

Lybrand, *A Review of Acquisitions Experience*, May 1993 (see ASB, 1995c, p155):

- Expanding market share or protecting an existing market position
- Geographical expansion in core business
- Acquiring a related business or product
- Diversification of a seasonal or cyclical business
- Acquiring market skills or distribution facilities
- Acquiring expertise, know-how or technology rights
- Securing the supply of a key component, material or service
- Acquiring production facilities
- Rationalisation of production facilities and/or securing other economies of scale
- Increasing financial leverage, by acquiring a company with cash or low borrowings
- Acquiring a place of business in a country in order to gain access to protected markets
- Acquiring assets at a discount with a view to piecemeal disposal after acquisition
- Acquisition of tax losses
- Acquisition of Stock Exchange listing

*The measurement difference representing an overpayment*

The overpayment issue is important because the “differences” in the use of mixed measurement bases do not need to be recognised when they are immediately written-off.

The overpayment issue is often addressed as part of various attempts to decompose goodwill into the parts comprising its constituent nature – see Arnold et al and, Johnson and Petrone previously. It is seldom addressed as the sole reason for the existence of purchased goodwill. In this regard, Cook (ASB, 1995z, p92) argued that purchased goodwill should be charged immediately through the P&L account - what he referred to as “the biggest of baths”.

Kirkham and Arnold (1992, p424) argued that

“Unsurprisingly, while the concept of decomposing the goodwill figure has generally been accepted on a theoretical level, it has been predicted that it will prove to be practically problematic and politically unacceptable to preparers of accounts – so much so that one academic...suggested that the word ‘overpayment’ itself was sufficiently inflammatory to alienate the support of preparers. Indeed, it can be anticipated that few, if any, managers, would be willing to accept that they had overpaid for an acquisition. Nevertheless, empirical evidence suggests that overpayments do occur both in the US (Lev, 1986) and the UK (Limmack, 1991) and users of accounts might reasonably be expected to be interested in receiving information about them.”

According to Higson (ASB, 1995z, p46/47) overpayments to acquire a business were endemic, however, and it would be unreasonable to expect firms that have overpaid to readily acknowledge it. He argued, from an observation of the consistency of many market-based studies, that the

“...acquirer’s share prices tend to show zero returns around takeover. In other words, takeover is neither a value creating nor a value destroying event for acquirers on average. This should not be a surprise because it is consistent with a highly competitive market for corporate control. Where there are economic gains to takeovers the bidding process puts them in the hands of the selling shareholders. But it has very powerful implications for the value of goodwill, because if on average there would be many takeovers with positive abnormal returns for the acquirer, where the acquirer gains, and many where it loses.

Indeed, my evidence suggests that if stock prices are to be believed overpayment was a significant proportion of reported goodwill in the UK in many, many cases, most notably during the merger wave period between 1986 and 1991 when levels of goodwill were very high. During this period a majority of acquiring firms experienced a decline in share price when they announced a takeover. The implication of that is that in the majority of cases goodwill was overvalued. In many cases that was quite extreme and in getting on for 20% of cases the overpayment element constituted at least half, and in some cases all of the recorded accounting goodwill. In fact, in 7% of takeovers over that period the market immediately wrote down the value of the acquiring firm by more than the total of the accounting goodwill. So we must not imagine that overpayment for goodwill is a rare event. I think it is endemic for good market reasons.”

The comments presented by Higson imply that the overpayment element of purchased goodwill should be expensed. Of the remaining goodwill some or all of it may contribute towards the creation of future economic benefits but, nevertheless, may be so inseparable, so nebulous, so doubtful as to its ‘assetness’ as to be unidentifiable and therefore, should also be expensed (see Johnson and Petrone’s category 5 and 6 previously). One is then left with the possibility of extracting some identifiable intangibles, such as brands, from the remaining goodwill (see Johnson and Petrone’s category 1 and 2 previously) such that what remains thereafter may be insignificant. Of course, this presupposes in the first place that a goodwill “difference” has economic substance and may be hiding intangible assets. The market certainly appears to value goodwill but as to what exactly (asset by asset) is being valued: that remains unknown. It suggests that where intangible assets are identifiable they should be capitalised, and the remaining purchased goodwill should be written-off as quickly as possible. However, this was rejected by Higson on the rather dubious grounds that “The big problem with write-off, and I think its fatal flaw, is the loss of audit trail” (p50). It was therefore surprising that Higson advanced the case for amortising goodwill on what appeared to be entirely pragmatic grounds, specifically, the goodwill debate had gone on too long and compromise was called for.



Herz, Iannaconi, Maines, Palepu, Ryan, Schipper, Schrand, Skinner, Vincent (2001, p168, square brackets added) were concerned about the residual nature of purchased goodwill and establishing a reliable estimate of any impairment to it. The approach was entirely measurement focused:

“Current accounting rules measure goodwill at the acquisition date as the residual or difference between the price paid for the target and the fair value of the target’s net assets. If goodwill is subsequently measured as the total value of the acquired equity estimated by a RIM [residual income model] or DCF [discounted cash flow] valuation model less the fair value of net assets, then goodwill continues to be measured as a residual. Thus, both at acquisition and subsequently, goodwill is not a separable asset and must be measured as a residual under either current accounting standards or the impairment approach. The residual nature of the calculation [of] goodwill complicates [the] interpretation of its value.”

Herz et al argue that DCF and RIM will typically produce similar results in determining the market value of a business, however, it is in the comparison of that value to the fair value of the acquired assets of a business that the problems arise. For example, they argued (p169):

“First, target firms are often merged into the parent firm or with subsidiaries of the parent, making separate performance evaluation and accounting measurement infeasible...Second, even if the target retains its independent existence, changes in acquisition goodwill are indistinguishable from changes in post-business combination internally generated goodwill, precluding separate measurement and impairment testing of the two types of goodwill.”

The focus of the paper was again measurement-based, that is, the valuation of the acquired business vis-à-vis the fair value of the separable assets acquired. It was, respectively, a ‘valuation less valuation’ approach (outside the existing accounting structure) as opposed to a ‘cost less fair valuation’ approach (inside the existing accounting structure) per the accounting definition of purchased goodwill. However, the above conclusion was recognition-based, specifically, that the measurement of any residual on whatever basis was “infeasible” when merged into the parent firm from which it then became “indistinguishable”. It is suggested that this comment supports the stance that asset

recognition is logically prior to asset measurement on whatever basis, mixed or otherwise. On this basis the distinction between a purchased intangible asset and an internally generated one is irrelevant.

#### **2.4. The recognition of internally generated intangible assets.**

The measurement and disclosure of purchased goodwill and intangible assets can occur at the same time that internally generated goodwill and intangible assets of the same type are not recognised or disclosed within the existing accounting structure. The comparison of internally generated goodwill and purchased goodwill is a way of questioning the asset status of goodwill because of the divergent accounting practices for what is essentially the same 'asset'. Egginton (1990, p195) argued

“That this is not logical. The magnitudes of cost of many internally developed intangibles, such as R&D and advertising, are no less identifiable than the costs of a takeover, and the future benefits from a takeover are unlikely to be more certain than those from internally developed intangibles. Thus there is a serious problem of accounting comparability between companies which acquire intangibles externally and those which develop them internally.”

Equally, Ma and Hopkins (1988, p79) argued that:

“...internally generated goodwill, which has a meaningful interpretation...is not recognized, while goodwill on acquisition is recognized although, as recorded by accountants, it cannot be interpreted meaningfully and is not identifiable with a specific source. By choosing to identify this latter category of goodwill exclusively with the purchase entity, accountants have opted for convenience rather than reality. The manifest danger is the practice of Alice-in-Wonderland accounting, which will lead inescapably to a loss of professional credibility in the business community.”

Ma and Hopkins, in common with Herz et al (2001), adopt a valuations-based approach where the value of goodwill is the difference between the total value of a firm and the aggregate of the value of the separable net assets. With such an approach the distinction between internally generated goodwill and purchased goodwill is irrelevant, hence the above comment. It is a 'value deduct value' approach to goodwill rather than a 'cost

deduct value' approach as with the definition of purchased goodwill. Grinyer and Russell (1992, p111, square brackets added) comment that Ma and Hopkins "...analysis then logically follows from the valuation approach, but as that does not underlie current practice [i.e. acquisition cost deduct fair value of separable assets] their conclusions concerning the practical accounting treatment of goodwill are irrelevant." Russell, Grinyer, Walker, Malton (1989, p24, square brackets added) affirm this stance in the following terms:

"Obviously the exclusion of self-generated goodwill and the inclusion of purchased goodwill is anomalous if balance sheet values are used as a basis for profit measurement under the valuation approach. Both types of goodwill represent similar attributes and therefore under that approach deserve similar recognition. Yet HCA [historic cost accounting] is a 'matching' approach based on an entirely different rationale to that underlying 'valuation'."

Ma and Hopkins, above, refer to the possibility of Alice-in-Wonderland accounting where internally generated intangibles are excluded from the accounts. A valuations approach would certainly redress this situation and there are powerful proponents who would support this change in policy, for example, Arthur Andersen (1992, p11):

"In summary, Arthur Andersen believes that it is possible to codify the valuation methodologies and improve the general understanding of the valuation process, such that users and preparers of accounts can have more confidence in the incorporation of intangible assets into financial statements. This view is supported by the considerable consensus within the business and professional community regarding valuation methodologies, and by the evident acceptance of intangible assets valuation in the areas of taxation, mergers and acquisitions, licensing arrangements and fund raising. Valuers will always have to exercise caution, however, in determining whether any particular intangible asset is separable and its value is capable of reliable measurement."

However, the counter-argument is equally compelling: that valuations which are not grounded on recognisable transactions, as is the case with many internally generated intangibles, may also create Alice-in-Wonderland accounts where the resultant values are shown to be unreliable. The Arthur Andersen appeal to "consensus", above, is a common strategy for those seeking change but, as far as Napier and Power (1992, p94) were

concerned, valuation technologies are little more than ‘rational myths’ and the Arthur Andersen (1992) report, itself, an attempt at lobbying.

## **2.5. Exploring the boundary between an asset and an expense.**

The existence of a transaction is common to both an asset and an expense. As a consequence there is wide discretion in way elements are aggregated by accounting actors.

As the four previous sections have shown, asset measurement within the existing accounting structure is paramount in the asset recognition process. The subsequent allocation of the measurements to either an asset element or an expense element is largely a matter of judgment. And this judgment has been questioned in the value-relevance literature. Specifically, the distinction between a value-relevant asset and a non-value-relevant expense was not always clear-cut. Amir and Lev (1996, p5), for example, in respect of the wireless industry, stated:

“Current disclosure is inadequate, particularly because it does not distinguish between regular expenses and investment in intangibles. For example, customer acquisition and license application costs are generally lumped with salaries and other expenses in the line item sales, general and administrative expenses. A clear separation between regular expenses and costs which potentially enhance future cash flows will assist investors in the valuation of cellular companies.”

Some examples of the difficulties in distinguishing a value-relevant asset from a non-value-relevant expense are presented in Table 2.1. This is important because the recognition of an intangible asset is located at the boundary between an asset and an expense and the separable nature of an asset as distinguished from an expense.

Table 2.1: Value-relevant ‘assets’ treated as expenses for accounting purposes

Linsmeier, Boatsman, Herz, Jennings, Jonas, Lang, Petrone, Shores, Wahlen (1998, p313)

comment that:

“Expenditures on research and development (hereafter R&D), and to a lesser extent advertising, not currently recognized as assets contribute to firm value. That is to say, the capital market ascribes asset-like status to such expenditures...Acquired goodwill also contributes to firm value in a manner similar to other intangible-type items.”

Lev and Sougiannis (1996, p134) used R&D amortisation rates to compute R&D capital and to adjust reported earnings to reflect the capitalisation of R&D. They found that:

“The major outcomes of these adjustments, the corrections to reported earnings and book values for R&D capitalization, were found to be strongly associated with stock prices and returns, indicating that the R&D capitalisation process yields value-relevant information to investors.”

Hirschey and Wygandt’s (1985, p327) comment:

“Our results show a positive effect of advertising and R&D on the market value of the firm, thereby suggesting these expenditures should be capitalized and then amortized rather than treated as an expense as incurred. While our results suggest a one-to-five-year “life” for advertising and a five-to-ten-year life for R&D, we believe further research on the factors affecting these estimates is necessary before sufficient information is available to develop an appropriate accounting policy.”

In support of the short-term capitalisation of advertising, Guilding and Pike (1990, p48) state:

“The marketing asset input that probably best lends itself to a consideration of a form of deferred costing or amortisation treatment is advertising. Concern that amortisation of advertising costs is an arbitrary exercise can be countered by noting the degree of subjectivity involved in depreciation, which, despite this subjectivity, is the generally accepted, rational mode of accounting for fixed assets.”

In addition to Table 2.1, the value-relevance literature points to intangible assets at the boundary between an asset and an expense. In other words, there are ‘assets’, such as software and brands, where there is considerable discretion over their capitalisation or not, and, with such discretion, inconsistency of accounting treatment between companies – see Table 2.2.

**Table 2.2: Value-relevant intangible assets**

Aboody and Lev (1998, p162/3), for example, refute an assertion made by the US Software Publishers Association that software development costs are not a useful predictive factor of future product sales and, by association, to the future economic benefits derived from them.

Aboody and Lev show that:

“For a sample of 163 firms during the period 1987-95, we find that annually capitalized development costs are positively associated with stock returns and the cumulative software asset reported on the balance sheet is associated with stock prices. Furthermore, software capitalization data are associated with subsequent reported earnings, indicating another dimension of relevance to investors. We find no support for the view that the judgement involved in software capitalization decreases the quality of reported earnings.”

Barth, Clement, Foster, Kasnik (1998), from an observation of 595 companies, found that brand value estimates were significantly associated with equity market values. They stated (pp62/63):

“We use a sample of 1204 brand value estimates collected from FW’s [*FinancialWorld*] annual surveys of brands relating to 1991 to 1996 fiscal years to test the joint hypothesis that brand values are relevant for equity valuation of firms owning brands and FW brand value estimates are sufficiently reliable to be reflected in share prices. Our tests are based on estimating the association between the FW brand value estimates and share prices, incremental to book value of equity and net income, and the association between year-to-year changes in the brand value estimates and annual returns, incremental to net income and changes in net income. We find consistent evidence that brand value estimates are significantly associated with equity market values in both specifications, providing evidence in support of our hypothesis.”

In contrast, Mather and Peasnell (1991) found that internal estimates of brand values did not appear to add anything to the information that was already available to the stock market.

From an analysis of 13 brand capitalising companies they found (p163):

“...little support for the hypothesis that the stock market systematically under-values companies with large investments in intangible assets. There is some indication that share price gains were positively related to the size of the change in book values brought about by capitalizing brands...but there is reason to believe that this relationship is largely spurious and disappears when allowance is made for the simultaneous release of other good news.”

In addition to the above tables there is similar evidence from within the existing accounting structure of the difficulty of distinguishing an intangible ‘asset’ at the boundary between an asset and an expense. This is undertaken by reference to the results of a

longitudinal survey presented later at the end of chapter seven. A major influence in this regard is the connection of asset recognition to the requirement of a recognisable transaction or event, per the definition of an asset. Lev and Zarowin (1999, p365) comment that:

“Essentially, while the accounting system is primarily based on the reporting of discrete, transactions-based events, such as sales, purchases, and investments, the impact of change on business enterprises is rarely triggered by specific transactions. Change, internally (e.g. product development) or externally (e.g. deregulation) driven, often affects enterprise value long before revenue and expense transactions warrant an accounting record. Investors generally react to the impact of change on business enterprises in real time, hence the increasing disconnection between market and accounting values”.

The implication here is that accounting transaction-based cost may take some time to ‘catch-up’ with current market values presumably through revaluations and the like.

However, it is also possible that some records of account may never ‘catch-up’ at all because accounting systems do not recognise the transaction in the first place, for example, as with some internally generated intangibles. So, it is not a question of whether a transaction is allocated as an expense or an asset or whether the asset is valued in current terms, it simply is not recognised within the existing accounting structure. So, let us consider an alternative basis for asset recognition from the literature.

## **2.6. The separable recognition of an asset prior to, rather than on the basis of, measurement.**

With the exception of the few asset recognition studies presented in section 2.1, most of the remaining studies reviewed so far take the defined existence of purchased goodwill for granted and thus, by extension, its mixed measurement nature. Asset recognition is therefore, to repeat, on the basis of asset measurement despite the fact that asset recognition is logically prior to asset measurement. As we saw in respect of section 2.4, the overriding requirement is for measurement to be initially transactions-based rather than

on the basis of an independent valuation. Hence, the exclusion of internally generated intangibles from the balance sheet, except on the basis of a readily ascertainable market value or RAMV (ASB, 1997, p14), which, of course, is still transactions-based.

There is nothing to stop the profession from using valuations independently of transactions-based cost or RAMV but the resultant subjectivity is currently unacceptable to a profession that argues the case for the reliability of measurement associated with a transaction. In particular, the subjectivity of discounted cash flow techniques where they are used in the pursuit of an economic valuation, such as those so often used in the creation of brand valuations. Barwise et al (1989, p31), for example, argue that there is no objective way of separating a brand's incremental profit or cash flow from that of the rest of the business. Yet, if valuations could be held, or made, to be as reliable (however that may be determined) as transactions-based measurement, then asset recognition and asset measurement could be separated as two logically sequential steps. In other words, the current logic of Napier and Power's (1992) "measurement separability" could be reversed, thus allowing for the separable recognition and then the separable measurement of an asset. Instead, they comment (Napier and Power, 1992, p90) in respect of valuations that:

"...such methods are claimed to be acceptable because separate identification is possible, but we argue that such methods determine, rather than depend upon, separability. Because of this apparent circularity, the acceptability of such methods cannot be determined simply by appeals to the idea of separability, because this idea is not independent of measurement."

Their reference to separability refers to the Companies Act 1985 Sch.4A,9(2):

"Assets or liabilities which are capable of being disposed of or discharged separately, without disposing of a business of the undertaking"



Separability in this regard refers to the nature of an asset and not to its measurement, as is the case with Napier and Power's (1992) measurement separability. But it is worth noting that

"...the concept of separability involved is the 'ontological' criterion of separate transferability, not the criterion of separate identifiability of the estimated attributable future cash flows. The latter strictly concerns the different issue of 'measurability'" (ASB, 1994a, p16 – comment from Archer)

Napier and Power's comment, above, therefore supports the dominant 'measurement only' viewpoint. However, it may be argued that asset measurement should not "determine" asset identification/recognition because, to repeat, the latter is logically prior to the former. Consequently there is no "apparent circularity." In contrast, it may be argued that measurement does indeed "depend upon separability", in particular, a separable function as espoused in the above Companies Act quotation. Otherwise one cannot be too sure of what one is measuring. Let us explore this logic further by reference to the separability initial recognition cycle (SIRC) diagram – Figure 2.1 (adapted from Tollington, 2002, p48).

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#### *The separability initial recognition cycle or sirc diagram*

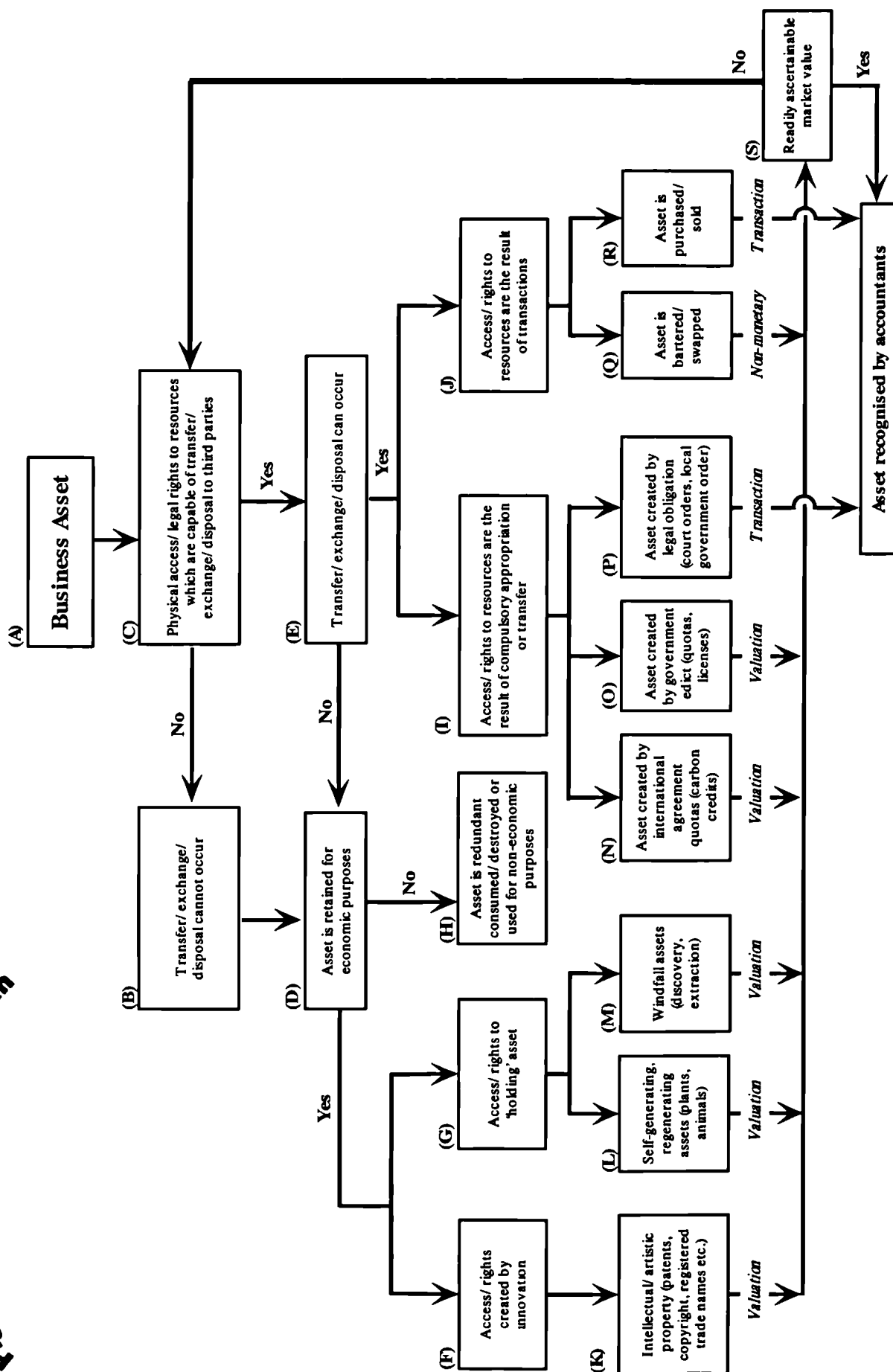
Each box in Figure 2.1, below, is labelled with a letter. They will be referred to in the subsequent analysis of the SIRC diagram. The most common manner in which an asset is separately recognised within the accounting domain is transaction-based, C-E-J-R, or events-based, C-E-I-P. However, the term "events" (ASB, 1999) has recently been expanded to include assets K-L-M. Also, the recent broadening of the existing asset recognition boundary to now include those assets having a "readily ascertainable market value" or RAMV (ASB, 1997, p10) can and does occasionally embrace the recognition of assets N and O. The list of assets is not exhaustive. For example, box A refers to business

assets but the list could, for example, be extended to include non-profit making assets as with public monuments (see Mautz, 1988, Pallot, 1990).

Most of the business asset types K to R can therefore be recognised by accountants; it is simply that their initial recognition as assets tends to be transaction-based. So, for example, the recognition of the internally generated Rolls Royce brand asset would have followed the C-E-D-F-K route and since S is not available the cycle would have repeated itself until such time that the Rolls Royce name was sold or licensed, for example, to BMW in 1998. In which case it would transfer to the C-E-J-R route and would be recognised as an asset, whereas, no asset was recognisable before. Yet, the common feature that binds both routes is box C, the fact that the Rolls Royce brand has a legally separable function whether that is by recognition of the intellectual or artistic property in its trademark or subsequently by a transaction.

Box C is pivotal and clearly requires further development if it is to be regarded as an alternative to the existing transactions-based recognition criterion. There is nothing to stop the accounting profession from recognising and capitalising intangible assets (box C) or, alternatively, not recognising and capitalising intangible assets (box B) using separability as the principal recognition criterion if they chose to do so. To repeat, the profession would probably have to accept valuations at the initial recognition stage for an asset, with all the attendant subjectivity that goes with it. In accepting valuations at the initial recognition stage of an asset, the circularity of SIRC would be broken and many more intangible assets could be recognised as assets on the balance sheet. Much would then turn upon the reliability of asset valuations. As we shall see in the next section, it was stance that was

**Figure 2.1 The SIRC diagram**



rejected by the Board, with the possible exception of asset recognition on the basis of readily ascertainable market values or RAMVs (ASB, 1997, p10).

Let us consider next the development of the UK regulatory structure relating to goodwill and intangible assets. As these regulations are reviewed it is important to keep in mind the comments raised in the six previous sections, in particular, the issue of asset measurement substituting for asset recognition within a transactions-based approach to accounting. This social structure was held to be immutable. Hence, the development of FRS10 was focused towards preferences for particular accounting techniques rather than many of the conceptually related issues raised so far.

## **2.7. Reviewing the regulatory framework leading up to the implementation of FRS10**

After reviewing the regulatory efforts of the ASC with regard to goodwill and intangible assets, the remainder of this section will focus on the regulatory efforts of its successor body, the ASB, as follows:

- a discussion paper (ASB, 1993), presented in section 2.7.1.
- a working paper (ASB, 1995a) for discussion at public hearings, presented in section 2.7.2.
- an exposure draft (ASB, 1996a), presented in section 2.7.3. and finally,
- a financial reporting standard (ASB, 1997), presented in section 2.7.4.

In 1980 the ASC published a discussion paper that adopted the traditional matching view towards purchased goodwill as the purchase of future profits to be matched over the period in which the profits were anticipated (see ASC, 1980a, para. 8.2). It followed the approach

of notable scholars in this regard, for example, Leake (1914, p82) and Spacek (1969, p297) who commented:

“Goodwill is the present value placed on anticipated future earnings in excess of a reasonable return on producing assets. Thus, it is the cost to the buyer of earnings over and above the cost of the assets required to produce those earnings.”

However, the exposure draft (ED30) that followed (ASC, 1982) also allowed as an alternative to capitalisation: the write-off of goodwill against reserves. Indeed, Holgate (1990, p12) commented that

“...the ASC initially asked[?] the panel to prepare an exposure draft on the basis of an immediate write-off of goodwill to reserves.”

In other words, preference or bias was ‘built-in’ to the process of accounting standard construction from the outset. According to Bryer (1995, p296), also at this time, the ASC ruled out the permanent retention of goodwill on the balance sheet. He concluded that “This was no principled restriction, but a *fiat*.”

In 1984, the first issue of SSAP22 on *Accounting for Goodwill* was released (ASC, 1984, revised 1989b) which allowed for both ‘capitalisation’ and ‘write-off’ with the latter being the preferred practice. Like the ASC, the International Accounting Standards Committee (IASC, 1983, revised 1998a) had a policy of both ‘capitalisation’ and ‘write-off’ (IAS22, para. 19 and 40). Since, capitalisation (asset) and write-off (non-asset) accounting methods are mutually exclusive, the implication to be drawn from the above circumstances was, again, that preferences were driving policy decisions without respective reference to the asset status, or not, of purchased goodwill. It followed that there could be no similar conceptually inspired policy with regard to ‘life expectancy’ and any related accounting method. At the time these preferences stood in sharp contrast to the US position which

advanced disclosure on the balance sheet and a specific life expectancy policy of write-off over 40 years.

In 1988 the Accounting Standards Committee (ASC) established a working party to consider amendments to SSAP22 *Accounting for Goodwill* (ASC, 1984, revised 1989b). SSAP22 theoretically allowed both the write-off of purchased goodwill to reserves as well as the option to capitalise and systematically amortise over a predetermined life. However, in paragraph 39 of the Standard, the ASC made it plain that, despite this dual stance, purchased goodwill should normally be eliminated from the accounts immediately on acquisition against reserves. Nobes (1992, p147) commented that:

“...members of the ASC may have felt guilty about allowing the option, and sought absolution through the ineffectual statement “should normally”, which was merely a reflection of what companies *did* normally”.

The working party was a reaction to a number of problems that arose in practice, such as:

- (a) a buoyant economy in the mid 1980's leading to an increase in takeovers and mergers and, with it, the goodwill premiums paid to acquire businesses. Higson (1990), for example, reported that as a result of rising share prices, the average ratio of goodwill to bidders net worth was around 3% from 1976 to 1983 rising to over 40 % from 1984 to 1987.
- (b) the problem of excessive reserve depletion arising from goodwill write-offs to reserves, the preferred accounting option under SSAP22. The more extreme cases led to negative, net equity balance sheets. To mitigate against the problem, companies adopted two main approaches: firstly, negative reserve accounting where write-offs were held as 'dangling debits' on credit side of the balance sheet (see Tollington, 1994). Secondly, companies attempted to reduce the goodwill write-off by extracting intangible assets from purchased goodwill and separately capitalising them. In respect of brand capitalisation, the

subjectivity of the resultant valuations led to a notable report by Barwise, Higson, Likierman and Marsh (1989) recommending prohibition.

- (c) There were problems with the identification of the correct reserve for goodwill write-off, companies being 'creative' in the use of various types of reserves, other than through profit and loss. For example, in their 1987 accounts, Grand Metropolitan Plc used the revaluation reserve and WPP Plc used the share premium reserve for write-offs. The use of the revaluation reserve was subsequently banned in the Companies Act 1989 but the use of the share premium account, subject to Court approval, continued to flourish up to the implementation of FRS10 (ASB, 1997).

In 1990, ED47 on *Accounting for Goodwill* (ASC, 1990a) and ED52 on *Accounting for intangible fixed assets* (ASC, 1990b) were issued by the ASC. ED47 recommended that the practice of eliminating purchased goodwill against reserves should cease and be replaced by the capitalisation and systematic amortisation of purchased goodwill over its useful economic life, generally up to twenty years. ED52 recommended the capitalisation of intangible fixed assets at cost only if the historical costs of creating it were known and it was clearly distinguishable and capable of being measured separately from goodwill.

Capitalised intangibles would be subject to amortisation on the same basis as purchased goodwill. Both exposure drafts were subject to widespread disapproval: 72% disapproved of ED47 and 62% disapproved of ED52 (see ASB, 1993, p12). In particular, 93% and 80% of corporate respondents, respectively, disapproved of fixed-life amortisation (see ASB, 1993, p12). It led Singleton-Green (1990, p85) to suggest that the publication of SSAP22 was "the beginning of the end for ASC", words which were confirmed with the dissolution of the ASC in that same year, to be replaced by the Accounting Standards Board (ASB).



At the time, the arguments used against the systematic amortisation of purchased goodwill were: firstly, that goodwill did not wear out, secondly, that the amortisation period was arbitrary. The overall position was subsequently summarised by the ASB (1993, p13) as follows:

“...just over half of all the respondents, half of the large accounting firm respondents and over two-thirds of the corporate respondents were in favour of a method whereby purchased goodwill is capitalised and then subject to an annual review for impairment but not to automatic amortisation charges...”.

It also left the ASB with the dilemma of reconciling the proposals of its predecessor body, in ED47 and ED52, with the apparent demands of the profession not to amortise goodwill. Though speculative at this stage, this may have had some bearing on the subsequent choice of a combination accounting method comprising these two positions, as finally presented in FRS10.

In June 1992 the IASC issued exposure draft ED45 (IASC, 1992, para. 46) that proposed the single policy of capitalisation and amortisation of goodwill and which led to an amendment to that effect in IAS22 (IASC, 1983), in 1993. In 1998, IAS22 (IASC, 1998) was revised again and followed the UK example in FRS10 (ASB, 1997) of the rebuttable presumption of a 20 year life expectancy for purchased goodwill. The development of the IASC and ASB policies on goodwill and intangible assets during this period was therefore closely aligned to each other. Indeed, David Tweedie's (ASB Chairman, now IASB Chairman) preference for international comparability was highlighted by the following exchange with Mr Chitty (ASB, 1995x, p32):

“The other thing that I would like to ask you about is that you mentioned that we should not really follow the International Standards Committee and that we should ignore the external situation. That is almost counter to the Board's philosophy in a way. I think that the view that the Board has been adopting is that, in fact, UK accounting should move more into the international main stream. By all means look to lead, but we should not deliberately walk in the other direction unless we genuinely think that there are special



cases in the UK (fiscal cases or something like that) that change the situation here or that, in fact, we think the international proposals are wrong.”

This is an important point to note when we get to the issue of the domination structure in chapter six but, for now, all that should be noted is the “philosophy” of adopting the “international main stream”, one based on capitalising purchased goodwill and intangible assets.

### **2.7.1. ASB Discussion Paper on Goodwill and Intangible Assets (ASB, 1993)**

The 1993 discussion paper started from the premise that intangible assets and purchased goodwill were essentially the same thing and therefore intangible assets should be subsumed within it. The discussion paper then presented six possible accounting methods for purchased goodwill, three asset-based (A, B,C) and three elimination-based (D, E, F), in Figure 2.2:

**Figure 2.2: Accounting methods proposed in the discussion paper (ASB, 1993, pp6-7)**

**Method A:** Purchased goodwill is capitalised, then amortised, over a predetermined finite life subject to a maximum of, for instance, 20 years. Its amortised carrying value is assessed each year for recoverability.

**Method B:** Purchased goodwill is capitalised, then amortised through the application of systematic annual review procedures to estimate the required annual amortisation charge. There may be years when the annual amortisation charge is zero.

**Method C:** A combination of methods A and B above. Method A would be used for most acquisitions, but method B should be used in special circumstances such as where the goodwill has an indeterminate life expected to be greater than 20 years.

**Method D:** Purchased goodwill is eliminated against reserves immediately on acquisition.

**Method E:** Purchased goodwill is transferred to a separate goodwill write-off reserve immediately on acquisition.

**Method F:** Purchased goodwill is transferred to a separate goodwill write-off reserve immediately on acquisition and the balance in this reserve is assessed for recoverability at each year-end. Losses reducing the recoverable amount below the balance in the write-off reserve are charged to the profit and loss account.

Consideration of these accounting methods led the Board to recommend two methods (ASB, 1993, para 8.1.1):

- a combination of ‘capitalisation and predetermined life amortisation’ and ‘capitalisation and annual review’ [method C]
- ‘separate write-off reserve’ [method E].

Let us consider method E. The rationale for method E was to disclose purchased goodwill separately within reserves as a negative reserve, thus creating the counter-intuitive concept of a negative source of funds. That is, so that investors could make up their own mind on the success or otherwise of acquisitions (see ASB, 1993, para.7.2.1 and para.7.3.2). It was recognised in paragraph 7.2.2 of the discussion paper that the benefits giving rise to the purchased goodwill were *similar in nature to assets*, which would tend to favour method C and other asset-based approaches. However, it was

“...believed that the difficulty involved in measuring such benefits was such that it was inappropriate to show these benefits as assets on the balance sheet” (ASB, 1993, para 7.2.2.)

Instead, goodwill was to be shown on the balance sheet as a negative credit rather than as a positive debit as in the case of method C, the other preferred method. The key issue here was whether, despite being referred to as an elimination method, the disclosure of a separate write-off reserve on the face of the balance sheet, albeit as a debit on the credit side, meant that it was not actually eliminated. It follows, if correct, that there was little difference between methods C and E, except in the subsequent application of impairment reviews. In support of this assertion, see paragraph 7.3.1 where it states that

“Users can clearly see the net worth of the business, and management can explain that the separate write-off reserve is simply an accounting adjustment, *not related to a loss of value*” (ASB, 1993, para 7.3.1, italics emphasis added).

Purchased goodwill is therefore regarded as having *value* and to repeat, is *similar in nature to assets*. Therefore, it should not be written-off. However, the reason given for its disclosure, as if it was written-off, was that it was

“...assumed to be so difficult to provide reliable information in respect of the continuing value of goodwill...that this is not attempted” (ASB, 1993, para.7.2.1).

Yet, contradictorily, it was successfully attempted with the alternative method C. It is reasonable to conclude the Board was predisposed towards the capitalisation of purchased goodwill – a preference for asset-based approaches. It is suggested that a more logical selection would have been between method C and method D (the SSAP22 immediate write-off approach) because at least with method D purchased goodwill was actually eliminated.

Whilst the choice between methods C and E were described in terms of conceptual viewpoints (see ASB, 1993, para.8.1.2), these conclusions were not grounded on the asset status, or otherwise, of purchased goodwill. This was taken for granted as a defined and recognisable figure arising from a business acquisition. This is important because it is a contention of this thesis that had the Board grounded the debate on the asset status or ‘assetness’ of purchased goodwill and found it, for example, to be an asset, then elimination methods D to F could not have been justified. Also, the opposite is true and capitalisation methods A to C could not have been justified. At this early stage, however, no definitive conclusion was reached other than to give Board support to accounting methods C and E (see ASB, 1993, para.8.1.1).

The responses to the discussion paper were summarised by the ASB in the subsequent working paper.

### **2.7.2. ASB Working Paper on Goodwill & Intangible Assets for discussion at public hearing (ASB, 1995a).**

Repeated reference will be made again to the six accounting methods A to F presented in Figure 2.2 in section 2.7.1.

The Board noted that in the intervening period between the discussion paper and the working paper that the International Accounting Standards Committee, in IAS22 *Accounting for Business Combinations* (IASC, 1983, revised 1998a), had prohibited SSAP22's preferred accounting method D, immediate write-off to reserves. The Board, therefore, demonstrated some foresight or knowledge of what was going to be an international trend towards the capitalisation of purchased goodwill.

According to the Board (see ASB, 1995a, para.1.1.10), there was no consensus on the choice of accounting method A to F in the discussion paper:

34%, the highest response, supported method E separate goodwill write-off reserve, 50% preferred capitalisation with 25% opting for method A (the predetermined life amortisation method) and 25% opting for method B (the annual review method). It was an interesting way in which the Board chose to present the information: combine the responses to methods A and B to show that the combined percentage, 50%, was greater than for the single method E elimination method at 34%. Though speculative, could it be that the Board was disappointed with the level of support for asset-based methods? The Board certainly acknowledged that it had a dilemma in seeking a consensus on the issue (see ASB, 1993, para.1.1.13).

The Board took steps to meet the concerns of respondents to the discussion paper over the separable disclosure of intangible assets. In this regard, the Board's approach could be viewed as a process of consultation and consensus building, the latter not always being a product of the former. The approach was as follows (see Figure 2.3):

**Figure 2.3: The asset recognition basis for the capitalisation of intangible assets other than purchased goodwill**

"The proposed approach allows the recognition, in allocating the original cost of acquisition, of intangible assets separately from purchased goodwill provided their fair value can be measured reliably" (ASB, 1995a, para.1.1.15).

"The proposed approach attempts to align the treatment of purchased goodwill and intangible assets as far as possible, especially when the two are very similar in nature" (ASB, 1995a, para.1.1.16).

"Internally generated goodwill may not be recognised" (ASB, 1995a, para.2.1.1).

"Internally developed intangible assets may be recognised only when there is either a specific accounting standard allowing their recognition or when they have a reliable market value obtainable from frequent transactions in a homogeneous population of identical assets" (ASB, 1995a, para.2.1.1).

In the discussion paper, for as long as intangibles were to be subsumed within purchased goodwill (ASB, 1993, para.3.2.12), few doubts needed to be raised about 'reliability of measurement' because this occurred within a known transaction-based cost for the acquisition of a business. Indeed, it is possible to speculate that this was the principle reason for their subsumption within purchased goodwill in the first place. As a result there were virtually no references to reliability of measurement in the discussion paper. However, as soon as intangible assets, other than purchased goodwill, were to be capitalised separately on the balance sheet, two developments arose. First, was the apparent reluctance of the Board to embrace this development because they still wished to "align" intangible asset accounting practice to that which was to be adopted in respect of purchased goodwill – see Figure 2.3. Second, the fair value assessments of intangible assets could only arise in the context of a business acquisition and such values were

capped anyway by the total amount of purchased goodwill arising from this circumstance. Thus, if the purchased goodwill was zero, then there were no intangible assets to be disclosed, even if reality suggested otherwise (see ASB, 1995a, para.4.1.13).

The Board proposed accounting method C as the single preferred method (ASB, 1995a, para.1.1.17) in the terms presented in Figure 2.4:

**Figure 2.4: The goodwill accounting method proposed in the working paper**

- (a) “Goodwill and intangible assets having finite lives should be depreciated over such lives [see also ASB, 1995a, para.2.3.1];
- (b) goodwill and intangible assets believed to have indefinitely long lives should not be depreciated [typically, supported by legal rights of an indefinite duration – see ASB, 1995a, para.2.3.2];
- (c) all recognised balances of goodwill and intangible assets should be reviewed for impairment at each year-end, the extent of this review would be minimal for goodwill and intangible assets having a life that does not exceed twenty years and fuller otherwise; and
- (d) there should be a rebuttable presumption that goodwill has a finite life that does not exceed twenty years [see also ASB, 1995a, para.2.3.3]”. (brackets added)

Points (a) and (d) in Figure 2.4 relate to predetermined life amortisation (method A).

Points (b) and (c) in Figure 2.4 relate to annual review (method B). In this way both methods A and B are combined to create method C. This allows the support of the 50% of those responding to the discussion paper to be, in some sense, satisfied.

Continuing with the observation that the Board was mindful of international developments, it commented that the above proposals in respect of annual review were “being developed alongside more general proposals for reviewing all assets for recoverability” (para.1.1.18). These proposals would undoubtedly have taken into account FAS121 *Accounting for Impairment of Long-Lived Assets to be Disposed Of* (FASB, 1995).

The accounting method C having been recommended (selected?), the focus of a large part of the working paper was directed towards measurement related issues, importantly, the

concern with reliability of measurement. This was partly because with method C it is possible to selectively recognise internally generated intangible assets (but not internally generated goodwill) on the basis of their 'readily ascertainable market values' (RAMV)(ASB, 1997, p14). The Board identified very few types of intangible assets for which there was evidence of frequent transactions in the market place – a necessary requirement for a RAMV. It did not include well-known and unique items such as brands and software (see ASB, 1995a, para.4.1.9), rather, items such as operating licences and quotas (see ASB, 1995a, para.4.1.7). It also sought to permit the use of replacement cost for some intangible assets, such as restaurant franchises, where there was a continuing market for the legal right to a transferable franchise (see ASB, 1995a, para.4.1.8). In addition, there was a reliability of measurement issue associated with the use of fair values for the recognition of intangible assets (see ASB, 1995a, para.4.1.11)..

The Board argued that the existence of a natural ceiling of a transaction-based cost for purchased goodwill differentiated the reliability of measurements associated with purchased intangible assets and internally generated intangible assets (see ASB, 1995a, para.4.1.13). Apart from where asset recognition occurs under another accounting standard, the clear indication here is, again, of the dominance of transactions-based methods, mostly at cost, also by RAMV. The reluctance to move away from transactions-based methods is deeply rooted in accounting. Thus, whilst the Board bowed to the pressure from respondents to the discussion paper in respect of the separable recognition of intangible assets, such disclosures, to repeat, are typically capped at the transactions-based cost for purchased goodwill.

The proposals presented in the working paper were subject to scrutiny at public hearings in December 1995. Thereafter, the Board issued FRED12 in October 1996.

### **2.7.3. Financial Reporting Exposure Draft No.12 (FRED12) (ASB, 1996a)**

The Board claimed (see ASB, 1996a, p3) that it received support for the overall approach proposed in the working paper. It also commented that no major changes had been made to this approach. In drafting FRED12 there were a few minor additions and refinements to the working paper. The most notable feature was confirmation of the asset status of goodwill and intangible assets in the following terms - see Figure 2.5.

**Figure 2.5: The requirements for capitalisation (source: ASB, 1996a, 1997)**

“Positive purchased goodwill should be capitalised and classified as an asset on the balance sheet” (FRED12, para6, FRS10, para7).

“Internally generated goodwill should not be recognised” (FRED12, para7, FRS10, para8 substitute “capitalised” for “recognised”).

“An intangible asset purchased separately from a business should be capitalised at its cost” (FRED12, para8, FRS10, para9).

“An intangible asset acquired as part of the acquisition of a business should be capitalised separately from goodwill if its value can be measured reliably on initial recognition. It should initially be recorded at its fair value, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value should be limited to an amount that does not create or increase any negative goodwill arising on acquisition” (FRED12, para9, FRS10, para10).

“If its value cannot be measured reliably, an intangible asset purchased as part of the acquisition of a business should be subsumed within the amount of the purchase price attributed to goodwill” (FRED12, para10, FRS10, para11).

“An internally developed intangible asset may be capitalised only if it has a readily ascertainable market value” (FRED12, para11, FRS10, para14).

And, following the adoption of method C, in their amortisation and/or impairment – see Figure 2.6.



**Figure 2.6: Useful economic lives and amortisation**

“Where goodwill and intangible assets are regarded as having limited useful economic lives, they should be amortised on a systematic basis over those lives” (FRS10, para15, FRED12, para16a, similar wording).

“Where goodwill and intangible assets are regarded as having indefinite useful economic lives, they should not be amortised” (FRS10, para17, FRED12, para16b, similar wording).

“There is rebuttable presumption that the useful economic lives of purchased goodwill and intangible assets are limited to periods of 20 years or less. This presumption may be rebutted and a useful economic life regarded as a longer period or indefinite only if (a) the durability of the acquired business or intangible asset can be demonstrated and justifies estimating the useful economic life to exceed 20 years; and (b) the goodwill or intangible assets is capable of continued measurement (so that annual impairment reviews will be feasible)” (FRS10, para19, FRED12, para12, similar wording)

“Where access to the economic benefits associated with an intangible asset is achieved through legal rights that have been granted for a finite period, the economic life of the asset may extend beyond that period only if, and to the extent that, the legal rights are renewable and renewal is assured. The amount of the asset that is treated as having the longer useful economic life should exclude those costs that will recur each time the legal right is renewed” (FRS10, para24, FRED12, para13)

“In amortising an intangible asset, a residual value may be assigned to that asset only if such residual value can be measured reliably. No residual value may be assigned to goodwill” (FRS10, para.28, FRED12, para17).

“The method of amortisation should be chosen to reflect the expected pattern of depletion of the goodwill or intangible asset. A straight-line method should be chosen unless another method can be demonstrated to be more appropriate” (FRS10, para30, FRED12, para18).

“The useful economic lives of goodwill and intangible assets should be reviewed at the end of each reporting period and revised if necessary. If a useful economic life is revised, the carrying value of the goodwill or intangible asset at the date of revision should be amortised over the revised remaining useful economic life. If the effect of the revision is to increase the useful economic life to more than twenty years from the date of acquisition, the additional requirements of the FRS that apply to goodwill and intangible assets that are amortised over periods of more than 20 years or are not amortised become applicable” (FRS10, para33, FRED12, para19 similar wording).

That said, the first item that strikes you most from a conceptual viewpoint, is the front-end summary objective of FRED12 (ASB, 1996a, p9):

“...to ensure that goodwill and intangible assets are capitalised only when they can be measured reliably at the time of initial recognition and that they are charged in the profit and loss account as far as possible in the periods in which they are depleted.”

The emphasis was clearly upon reliability of measurement, which, surprisingly, was not repeated in the equivalent objective in FRS10 (see ASB, 1997, p3). However, there were some doubts about exactly what was being capitalised and therefore, what was being measured: “goodwill arising on an acquisition is neither an asset like other assets nor an immediate loss in value” (ASB, 1996a, p9). The Board states that

“Although purchased goodwill is not in itself an asset, its inclusion amongst the assets of the reporting entity, rather than as a deduction from shareholder’s equity, recognises that goodwill is part of a larger asset, the investment, for which management remains accountable” (ASB, 1996a, p9).

Also, in respect of intangible assets, the Board argued that they

“...fall into a spectrum ranging from those that can readily be identified and measured separately from goodwill to those that are essentially very similar to goodwill” (ASB, 1996a, p9).

The interesting feature of this comment is the assertion that some intangible assets are similar to goodwill. Yet, purchased goodwill itself is not defined other than in terms of an operating “difference”, per SSAP22/FRS10. Being pedantic, one could argue that the Board was saying that certain, unspecified intangible assets are similar to a defined “difference”. As a consequence, there is no benchmark by which to judge the ‘assetness’ of these intangible assets other than reference to a measured “difference”, a transaction-based amount established at cost or, perhaps, by RAMV. The reliability of measurement established by transactions then becomes central to accounting policy choices, notably, to the exclusion of independent valuations at the initial recognition stage of an asset.

#### **2.7.4. Financial Reporting Standard 10: Goodwill and Intangible Assets (ASB, 1997)**

The differences between FRED12 and FRS10 were acknowledged by the Board itself in FRS10, pp67-69: see Figure 2.7

**Figure 2.7: Changes made following the exposure of FRED12**

“The removal of the procedures to be used in performing impairment reviews. They are to be published as a separate FRS encompassing the impairment of all fixed assets and goodwill. FRED15 ‘Impairment of Fixed Assets and Goodwill’ sets out the procedures to be used for impairment reviews until that FRS is published... simplification of the procedures for performing ‘first year’ impairment reviews. The Board accepts the argument that a requirement to perform a full first year impairment review for every acquisition would be unduly onerous. The FRS permits the first year impairment review to be performed on a simpler basis, with a full review being required only if the simpler review indicates a potential impairment ...” (ASB, 1996a, pp67-69, brackets added).

The “separate FRS” referred in Figure 2.7 item (a) was subsequently issued as FRS11 (ASB, 1998).

*Summarising section 2.7*

An attempt is made here to ascertain some of the major themes running through the ASB’s consultation documents, firstly, to tie them together but also, secondly, to provide some structure for the responses to them later on in this thesis, notably in respect of signification and domination.

The 1993 discussion paper started from the premise that intangible assets and purchased goodwill were essentially the same thing and therefore intangible assets should be subsumed within it. Of course, because the nature of “the same thing” had not been explored, the assertion was impossible to validate.

The discussion paper was focused primarily upon accounting methods A to F. The discussion paper referred to the dilemma which the Board faced in reconciling the conflicting approaches of an international trend towards method A whilst, at the same time, addressing the historical concerns of respondents to ED47 (ASC, 1990a), who

favoured method B. The final reporting standard was a hybrid of these two approaches: method C. The important point here is that methods A to C were all asset-based approaches. Further, an argument was developed in the critique of the discussion paper to the effect that the alternative approach, method E, was not actually an elimination method. Specifically, if the balance remained on the balance sheet, albeit as a negative credit rather than a positive debit, it could be viewed as capitalisation in a different guise.

For as long as the discussion paper advanced the notion of intangible assets being subsumed within purchased goodwill, reliability of measurement was not an issue because of the inherent reliability of a transaction-based cost measurement for purchased goodwill. As soon as internally generated intangible assets became recognisable, either on the basis of a readily ascertainable market value (RAMV) or as a valuation extracted from purchased goodwill, then the issue of reliability of measurement became of central importance in the ASB's deliberations. Thus, within the 1995 working paper measurement became the principal means of asset recognition. An asset could be identified as such but, nevertheless, it could not be recognised for accounting purposes because it could not be measured with sufficient reliability. FRED12 (ASB, 1996a, p9), for example, was very clear on this point:

“Its objective is to ensure that goodwill and intangible assets are capitalised only when they can be measured reliably at the time of initial recognition and that they are charged in the profit and loss account as far as possible in the periods in which they are depleted.”

So, one could summarise as follows:

(a) The debate opened with a selection accounting methods from which certain preferences were expressed early on, notably towards asset-based methods.

(b) The debate did not open with a discussion of any conceptual foundation, notably about the asset status of purchased goodwill. Thus, the defined nature of goodwill and the defined nature of an asset were taken for granted.

(c) Reliability of measurement, established by the dominant transactions-based approach to accounting, was central to accounting policy choices as to which intangible assets, including goodwill, would be recognised and capitalised.

## **2.8. A summary critique of the dominant ‘measurement only’ stance and a positioning of the contribution of this thesis in the literature.**

In section 2.1, Johnson and Petrone’s (1998, p296) analysis of purchased goodwill in relation to the definition of an asset told us nothing about the nature of the goodwill resource, which, as the earlier recognition studies in this section showed, were unclear anyway. All that apparently mattered was whether goodwill could produce “future economic benefits” because, comparatively, resource recognition is irrelevant when one is dealing with something that has an intangible nature (see Weetman, 1989, p34). Further linkages were made to the definition of an asset in terms of “control” but this was exercised indirectly through control of the business as a whole. It has to be that way because control over a defined goodwill ‘difference’ is somewhat problematic. Finally, Johnson and Petrone rightly argued that goodwill has a transaction-based existence per the definition of an asset, however, in response, it is not the central focus of the transaction to acquire a business. Rather, it is what is left over from the transaction to acquire all the other recognisable assets of a business.

In section 2.2, Napier and Power (1992) advance their notion of measurement separability rather than the separable recognition of the problematic resources that may or may not

constitute goodwill and the related intangible assets from the early recognition studies in section 2.1. It is argued that Napier and Power's 'measurement only' stance towards asset recognition (perhaps, a contradiction in itself) appears to overlook the fact that their separable nature is often secured by legally enforceable rights which can often be disposed of at some value regardless of the accuracy of their current measured value. Consequently, there is no "apparent circularity" (Napier and Power, 1992, p90), that is, asset valuations determining asset recognition. Indeed, it almost seems that at the heart of 'measurement separability' is actually the requirement for 'sufficient reliability' of measurement (ASB, 1999, p62). If true, and notwithstanding comments by Napier and Power to the contrary, measurement separability would also seem to prejudice transactions-based approaches and the linkage to the definition of an asset, because the measurement is initially deemed to be more reliable than valuation approaches.

Also in section 2.2, the value-relevance studies are used to show that some intangibles have economic substance or a value-content to them. However, in response to these studies, whilst one can test for a positively correlated relationship between reported goodwill and market value, in the absence of an understanding of the nature of goodwill, all one can actually say is that "something" is positively correlated. In fact, if goodwill actually encompasses some of the 'assets' referred to in the early asset recognition studies (section 2.1) then it is hardly surprising that, for example, McCarthy and Schneider (1995) observe a positive market effect since that was also the conclusion of similar studies subsequently reviewed in section 2.5.

In summary, the argument so far is that goodwill is separately recognisable because it is separately measurable and appears, like most assets, to produce future economic benefits.

But, the logically prior argument of “what exactly is doing this?” remained unanswered from the literature.

In section 2.3, three possibilities in respect of this question were explored. First, was the possibility that the fair valuation exercise that produced the purchased goodwill “difference” was either incomplete or incapable of separately identifying all the individual intangible assets arising from a business acquisition. The logical counter-argument to this stance is that the profession should find ‘better ways’ to recognise them other than on the basis of the ‘measurement only’ approach. Second, was the idea of purchased goodwill, or part of it, representing an alternative investment to an equivalent self-start option. Whilst attractive, the approach was, again, a measurement-based view that did not address intangible asset recognition. That said, if the benefits of avoiding the self-start option arose because of the acquisition of certain identified profit contributing intangibles, such as from some of those listed by Cooper & Lybrand previously, then this would be a useful contribution to the goodwill and intangible assets debate. Without this linkage the benefits that flow from purchased goodwill refer only to the operating circumstances of a start-up, not to the source of those benefits. No asset per se is identified. It is also possible to argue that the start-up expenditures do not in themselves produce future economic benefits, only indirectly in relation to other assets of a business, as when a machine is commissioned. In this regard the attachment to the Coopers & Lybrand list is important. In attempting to identify the constituent nature of what has been acquired one can start to distinguish those intangible assets that produce economic benefits from those that are more properly regarded as expenses, including any overpayment. Indeed, overpayment was the third and final reason advanced for the existence of a goodwill “difference. Underpinning all three

possibilities is a logical exhortation: to recognise first the nature of that which is to be measured, whether as a measured “difference” or on some other measurement basis.

Section 2.4 explored the argument that, conceptually, there can be no difference in nature between purchased goodwill and internally generated goodwill – both are goodwill and both are assumed to exist as assets. There was, for example, an assumption in the literature that internally generated goodwill replaced purchased goodwill over time (see ASB, 1995x, p99, 105) but this assumption was unsubstantiated. However, if one subscribes to the view that goodwill is simply a difference between two measurement bases, then if one adopted say, a full valuation-based approach to accounting, the distinction between internally generated goodwill and purchased goodwill would become irrelevant. This is because the movement in valuations between balance sheet dates replaces the matching concept and the need to identify individual transactions-based costs, and with it, the recognition and disclosure of the transactions-based cost of purchased goodwill alone. Thus, the debate of ‘purchased goodwill versus internally generated goodwill’ may be reduced to a debate about measurement bases and whether historic cost or market values should dominate in accounting, respectively.

Section 2.5 highlighted the inability of a transactions-based system of accounting to accurately distinguish between an asset and an expense, a critical problem for intangible assets, which exist at the boundary between them. This opens up the possibility of the additional use of asset recognition criteria to solve the problem. However, the Board (ASB, 1999, pp18-19) commented on the issue of asset recognition criteria in the following terms:

“An alternative approach might have been to avoid identifying any elements and instead rely on the recognition criteria. However, this approach is not viable because no



recognition criteria have been developed that provide clear and comprehensive answers to the questions posed during the recognition process without introducing circularity by, for example, referring to generally accepted accounting practices” (paragraph B4.2, *italics emphasis added*).

The above “alternative approach” appears to be presented in a mutually exclusive manner: one has to “avoid identifying the elements” in order to “instead rely on the recognition criteria”. However, as there is actually nothing in the literature to support such mutual exclusivity it is possible that one may be able to retain the existing elements-based approach to accounting and, at the same time, perhaps consider the introduction of asset recognition criteria in order to underpin the nature of an asset element. The literature review in this subsection suggested that there was certainly a need to accurately delineate an asset from an expense for accounting purposes.

Section 2.6 presented the position that separable ‘asset recognition’ was logically prior to ‘asset measurement’. It did not indicate which measurement basis to use once recognition had taken place but the clear implication from the analysis in the earlier sections was that a measurement “difference” could be avoided by the use of a single measurement basis in accounting.

The existence of an accounting regulatory structure that enables the exclusion of many non-purchased, internally generated intangible assets from the financial statements is one that emphasises the reliability of transactions-based measurement to the point where it dominates in the asset recognition process. This was a key point raised in section 2.7 and it is also one that links back to the central research question presented in section 1.1. Specifically, this social structure was largely taken for granted in the communication between the Board and the rest of the accounting collectivity during the consultation

process leading up to the implementation of FRS10. There were respondents who sought to overturn this stance, notably amongst the brand valuers, but this viewpoint was rejected by the Board on the grounds that there was no viable alternative to the reliability of transactions-based measurement.

The boundaries of this social structure are grounded on an overarching conceptual framework that purportedly guides the content of individual accounting standards: The *Statement of Principles* (ASB, 1999) and the *Accounting Policies* (ASB, 2001). This framework and individual standards, such as FRS10, are arrived at following processes of consultation, the purpose being to show to society that accountants act professionally and responsibly in their regulated construction of financial reality by consulting widely. The supporting morality is in the desire to regulate for the protection of investors against accounting malpractice as well as in the service provided to society through the provision of relevant and reliable financial information – a service that is deemed to be in the public interest. It is by such means that the profession seeks to legitimate its position in society but it is also one that is inherently limited, particularly in respect of the disclosure of purchased goodwill and the non-disclosure of internally generated intangible assets. Nevertheless, the legitimacy of this process is evidenced by usage and repetition over a long time.

There is also a desire for the accounting rules to collectively portray a true and fair view of financial reality. It is one that attempts to capture, albeit incompletely, the economic worth of a business, including the wealth related to intangible assets. However, the rules of accounting and the accompanying pursuit of a true and fair view of financial reality can sometimes be in conflict with each other, for example, on such matters as the non-

disclosure of internally generated intangible assets and the related argument that their exclusion from the balance sheet does not allow for a true and fair view. To repeat, the transactions-based stance dominates in this regard but how it does so that speaks directly about the exercise of power, for example, in enforcing regulatory compliance in practice.

Three elements have been respectively identified in the three previous paragraphs: the identification of what is significant in the accounting construction of financial reality concerning goodwill and intangible assets, how the profession legitimates that construction in the 'eyes' of society despite its incomplete nature and finally, the manner in which power is exercised by the profession so that its social construction dominates in practice. The three elements: signification, legitimation and domination are explained in chapters four, five and six. Before moving to these insights the next chapter explains the nature of Anthony Giddens's structuration theory justifying its use to explicate this understanding.

## **Chapter Three: Research Approach**

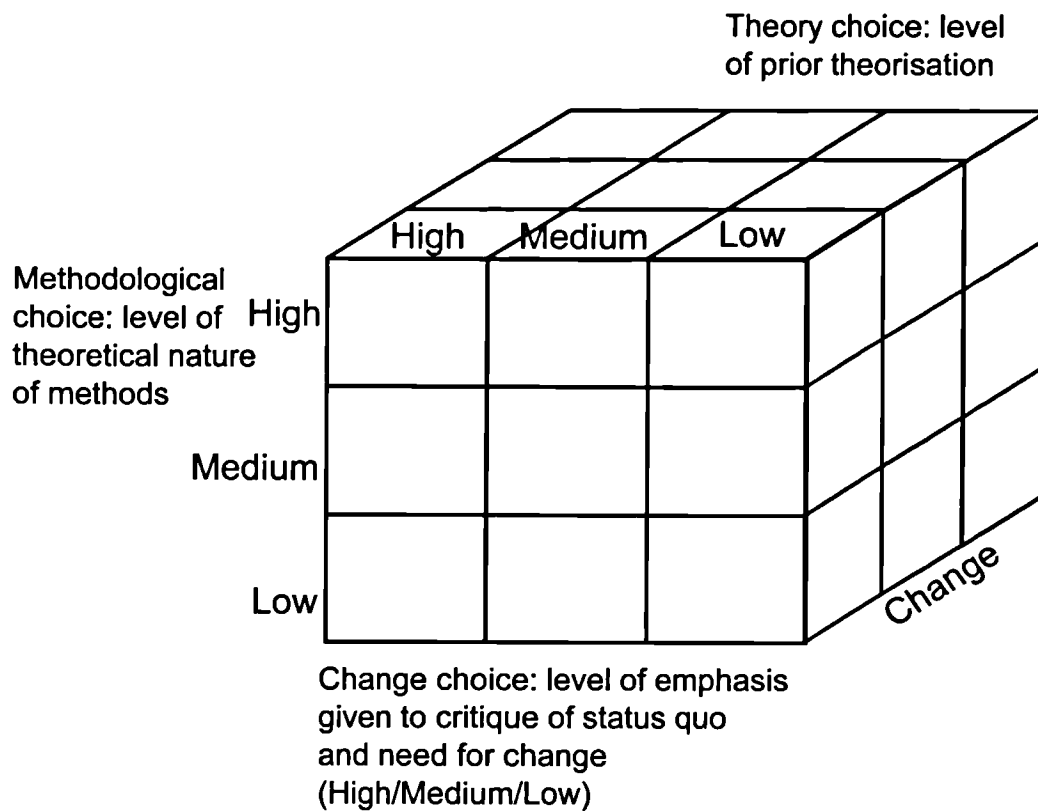
### **3.0. Introduction**

Intangible assets are socially constructed assets that exist because various sections of society decree that they should exist and establish processes for that purpose. In keeping with this sociological foundation on the issue of intangible assets, the analysis presented in this thesis is largely qualitative in nature, with only limited use of quantitative data in appendix A. It adopts both interpretative and critical perspectives. Both perspectives are concerned with how human beings act towards phenomena on the basis of the meanings that they attribute to them as observers of them. Also, that these meanings are themselves the product of social interaction and as such, are constantly being handled and modified through the individual interpretative processes applied to what they encounter. In section 3.1 these perspectives are examined in the context of an overview provided by Laughlin's (1995) "Middle Range" thinking. Positioning the research in the context of this overview limits the choice of research approach. In section 3.2, the choice of research method is presented and justified. In section 3.3, a discussion is presented on how the theoretical approach presented in the previous two sections can be applied in the practical context of accounting for goodwill and intangible assets.

### **3.1. Positioning the research**

Empirical research starts from certain ontological, epistemological and methodological assumptions. Laughlin (1995) has expressed those assumptions in terms of choices over "theory"(p66), "methodology"(p67) and "change"(p67):

**Figure 3.1: Laughlin's Theory, Methodology and Change Matrix**



Each choice requires to be located on a continuum ranging from high to low so that a reader is clear about the biases and exclusions contained in the thesis. These choices are briefly restated as follows:

(a) Theoretical choices: refers to the level of prior theorising and prior theories related to a particular piece of research work. This tends to shape the researcher's view about the nature of the world, what constitutes knowledge and how it relates to their particular focus of research. 'High' levels of prior theorising are indicative of an assumed material world which, despite empirical variety, has high levels of generality and order and has been well researched through previous studies. Any empirical investigation becomes little more than additional incremental study that tends to test a well-developed theory. However, 'Low'

levels of prior theorising, at the extreme, assume that the world is not material (being a projection of the mind) and since projections differ, generalities are impossible. Equally, learning from or relying on previous theoretical studies and insights is both inappropriate and potentially corrupting of the diversity and detail of an investigation.

In contrast with the High and Low dimensions Laughlin (1995, p81) states that 'Medium' levels of prior theorising

"...recognizes that generalizations about reality are possible, even though not guaranteed to exist, yet maintains that these will always be "skeletal" requiring empirical detail to make them meaningful...to "middle range" thinkers the empirical detail is of vital importance. It complements and completes the "skeletal" theory."

(b) Methodological choices: refers to the actual way of conducting an investigation which can either be defined according to the theoretical approach to the observation process or is more reliant on the implicit perceptual powers of an individual observer. A methodological choice is categorised as being 'High' where there is a high theoretical definition of the research method to be adopted, which will often involve a formal, replicable quantitative model. At the 'High' level there is an implicit assumption that the role of the observer is irrelevant to the research process and that his/her subjectivity or biases form little or no part of the proceedings. With a 'Low' methodological choice the observer is permitted and encouraged to be free to be involved in the observation process completely uncluttered by theoretical rules and regulations on what is to be seen and how seeing should be undertaken. This usually involves a qualitative research process. However, because it is reliant upon individual perceptions and the inherent ambiguities of language there is a repeated need to clarify meaning.

With middle range thinking on methodology, the theoretically defined nature of most research methods of observation is not abandoned, rather

“...the intention is to design a methodology which sets “skeletal” rules for processes of discovery which still allows for variety and diversity in observational practice...In this way it is part-constrained and part-free which again is a combination of the strengths of both approaches [High and Low] while avoiding the weaknesses of both (Laughlin, 1995, p81 and p84, brackets added).

(c) Change choices: refers to the attitude by a researcher concerning the worth or otherwise of maintaining the current situation that is being investigated as well as the necessity for actually doing something about the situation. At the ‘High’ end of the change choice continuum researchers are of the view that everything they see is incomplete and inadequate and in need of change. At the ‘Low’ end of the change choice continuum researchers see little problem in maintaining the status quo.

Those researchers whose views occupy the ‘Middle’ position have a more strategic attitude to change being open to certain aspects of current functioning but also to challenging the status quo. Laughlin (1995, p84) argues that in respect of the ‘High’ and ‘Low’ change dimensions:

“Both positions are arguably untenable and very extreme. Again the “medium” position holds open the possibility that the status quo should continue while also keeping open that change is required. This more balanced perspective, which neither argues that everything is right nor that it is wrong, calls for a rather more sophisticated model of change to make this judgement. It is this change model which is central to this “medium” position on the change dimension.”

Laughlin(1995, p82) also says

“...the medium position on change keeps open the possibility that in certain circumstances critique and ultimate change are important but not in other situations. This more conditional approach to critique and change is clearly more complex than either the deliberate exclusion as with the Comteans or the ontological necessity for exclusion as with the Fichteans. It requires a deliberate and deliberated evaluatory policy to decide when critique and change are appropriate.”

There are two implied points here, which are linked. First, positioning one's research on the change dimension other than in the 'Middle' is viewed potentially as "untenable and very extreme." Second, these "extreme" positions of 'High' and 'Low' change are underpinned by philosophical perspectives. For example, the second quotation above refers to the philosophers Auguste Comte and Johann Fichte respectively. Both philosophical perspectives, Laughlin argues, should be located on the 'Low' change dimension: "deliberate exclusion" and "necessity for exclusion", above. In comparison, a 'High' change positioning would be informed by a philosophical perspective such as that offered by Karl Marx. Laughlin, however, argues the case for a middle-range positioning and a supporting philosophical perspective informed by the work of Habermas (1984, 1987).

It is not just the change dimension which is informed by philosophical perspectives. Locating one's research on any combination of each of the three dimensions of 'theory', 'method' and 'change' is informed in the first instance by one's philosophical perspective on the world, which then tends to prejudice the use of related research methods. Three philosophical perspectives are presented in Figure 3.2: Comtean, Kantian/Fichtean, Kantian/Hegelian.

#### *The Comtean philosophical perspective*

Accounting researchers who approach the research site from a High theory, High method, Low change point of view will tend to believe in a world possessing definable patterns which can be observed through formal, often quantitative, investigative methods. The study may well be incremental to a well-established body of knowledge which is assumed not to change without empirically verifiable grounds for doing so. Such an approach,



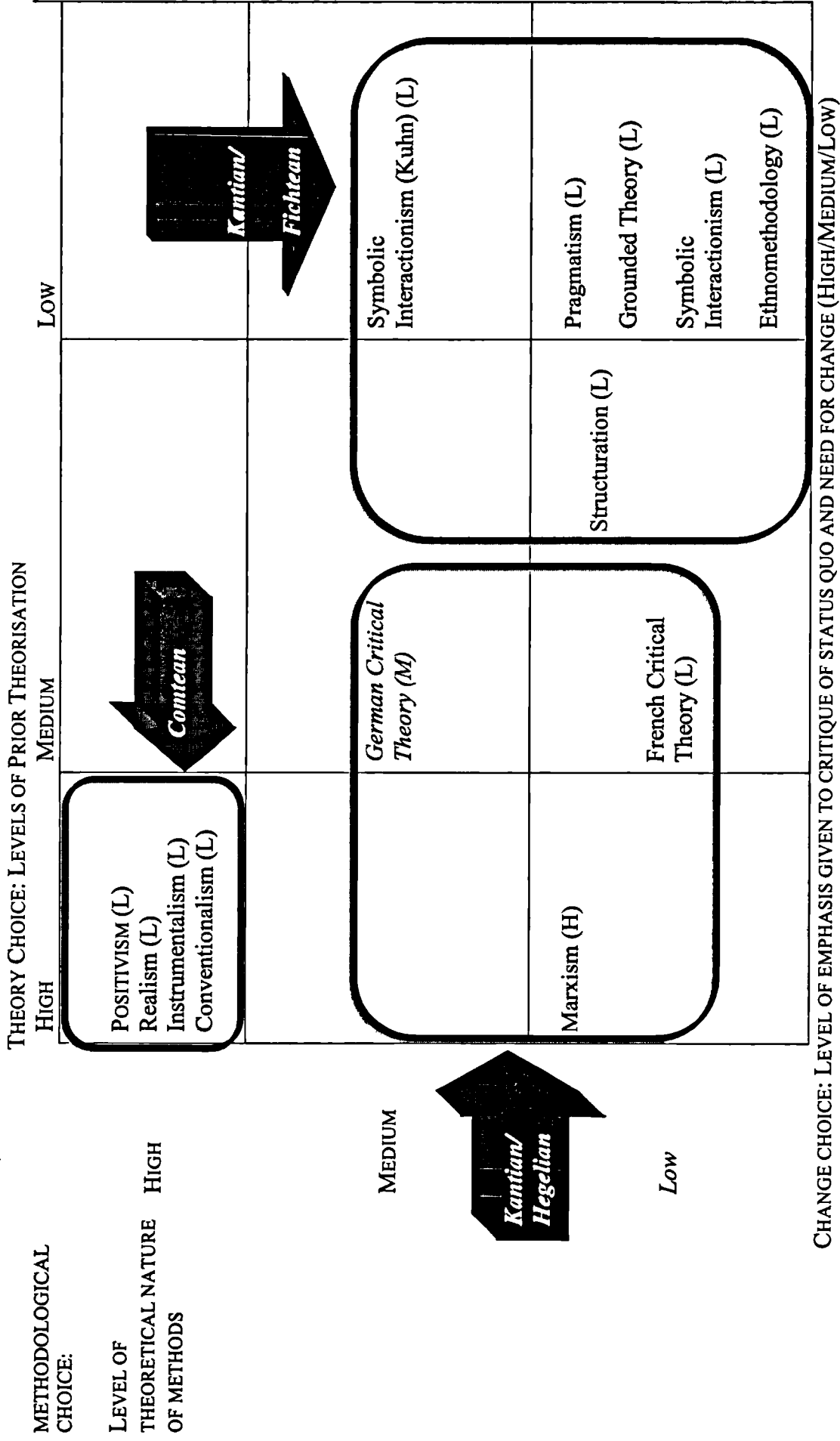
which is informed by a Comtean philosophical perspective (Auguste Comte 1798-1857), is very common in accounting research. The Comtean perspective is tightly clustered around the high theory, high method dimension in Figure 3.2. Of the four research methods shown 'positivism' is perhaps, the most well known method. It allows for an absolute description of the material world to be made free from observer bias.

#### *The Kantian/Fichtean philosophical perspective*

In contrast, a Kantian philosophical perspective (Immanuel Kant 1724-1803) is loosely clustered around the Medium- to-Low theory and Medium-to-Low method end of Laughlin's matrix (Figure 3.2.). According to the Kantian perspective all experience is mediated through human beings and as such, will always be conditional and subjective. Thus, in contrast to positivism, it is virtually impossible to separate the observer from what is being observed. Scruton (1982, p18) supports this assertion in the following terms:

"Objects do not depend for their existence on my knowing them; but their nature is determined by the fact that they can be perceived...They are objective, but their character is given by the point of view through which they can be known."

FIGURE 3.2 (SOURCE: R. LAUGHLIN)



Let us look at the Kantian perspective in more detail, in particular, derivations of it.

According to Laughlin (1995, p72)

“...two areas of ambivalence in Kantian thought are significant. The first is related to the ontological question concerning a material existence. If all insights are mediated through experience then to what degree is reality, real, tangible and distinct from our mental images? The second relates to critique and change in the subjective interpretation of observers. Are there any conditions in which it is possible to say interpretation X by individual Y is incorrect? Neither of these questions and concerns were adequately answered in Kant’s writing leading to major differing interpretations even in his own students. Thus his two most notable students (George Hegel and Johann Fichte) came to interpret Kantian thought in totally different ways because of these ambivalences. Hegel interpreted Kant’s thinking in such a way as to give emphasis to a material world which could be understood and misunderstood. He also gave emphasis to an ideal to which we should be aiming. These emphases, together, introduced notions of critique and change into understanding and action. Fichte, on the other hand, emphasized the highly subjective side of the ambivalences in Kantian thought. Everything to Fichte was a projection of our minds thus making a material existence uncertain. This led inevitably to a lack of critique in terms of interpretation. Put simply, if everything is a projection of our minds what right has anybody to question and challenge another person’s projections?”

To elucidate, a Kantian/Fichtean perspective

“assumes a world whose existence cannot be divorced from the observer’s perception of it, where generalisations cannot be assumed to exist and where understanding is subjective, specific and subjectively derived.” (Laughlin, 2000).

In this world there is no basis upon which to judge the superiority of one interpretation over another and, therefore, any attempt to do so can only be advanced and subjectively justified on the basis that it produces a ‘better’ view of reality. The key difference between this perspective and a Kantian/Hegelian perspective is that the Kantian/Hegelian perspective starts with the assumption of the existence of a material world. Consequently, any perception of the material world tends to be directed in the first instance towards the physical and visible aspects of it rather than to the non-physical and invisible.

### *The Kantian/Hegelian philosophical perspective*

In comparison, a Kantian/Hegelian perspective is positioned between the two extremes offered by a Comtean perspective and a Fichtean perspective. As can be seen from Figure 3.2, it embraces a high-to-medium theory, medium-to-low method perspective. The Kantian/Hegelian perspective

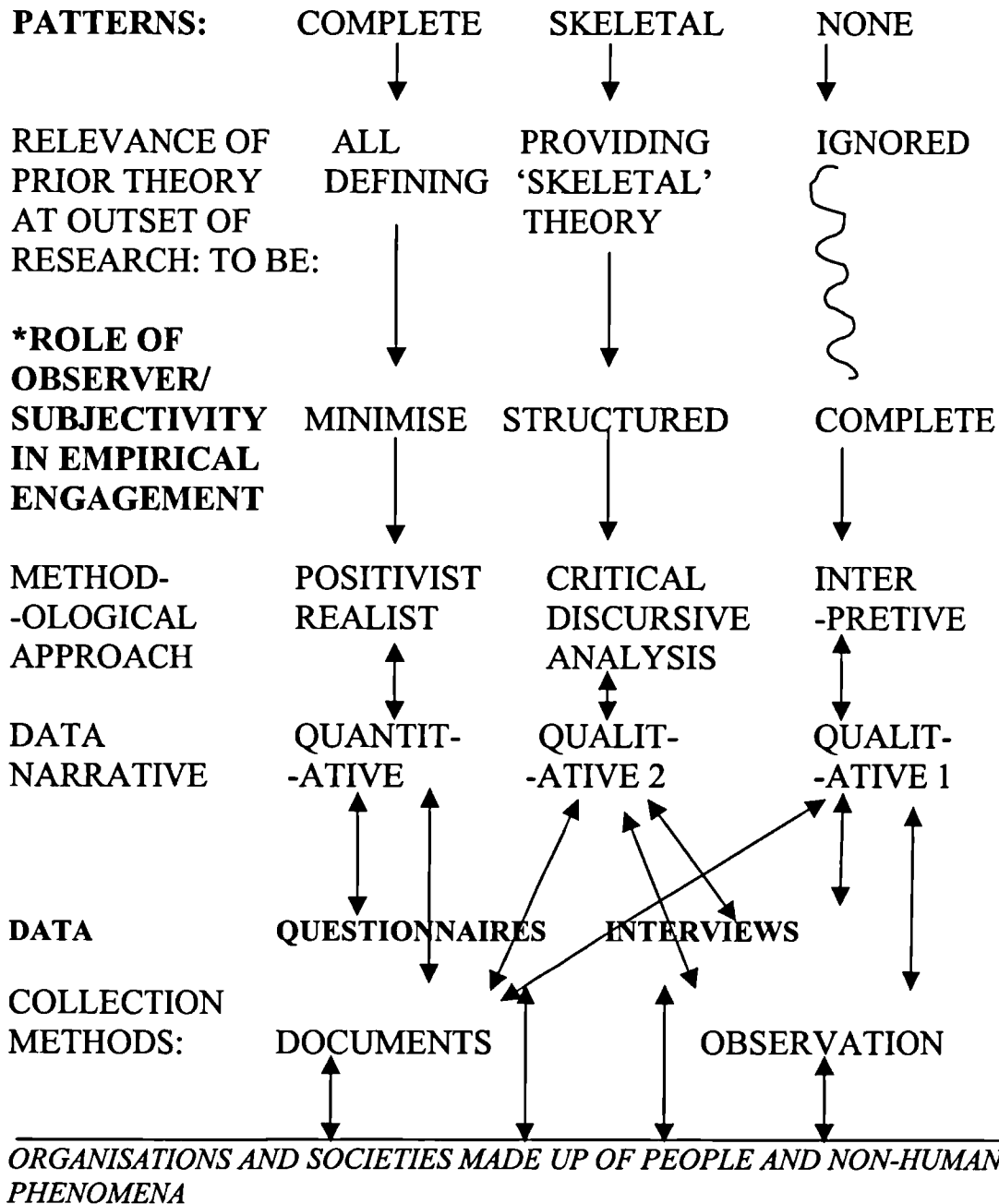
“Assumes a material world, which exists distinct from our perceptions but is mediated and moulded, to a degree, by our interpretation, where ‘skeletal’ generalisations exist but they can never fully encapsulate reality and where understanding can be accessed through a mixture of structured and subjective processes.” (Laughlin, 2000).

It is also interesting to note that all the individual research methods presented in the above Comtean and Fichtean ‘extremes’ emphasise low change in their respective objective and subjective stances: each maintaining their version of the status quo – see ‘(L)’ against each research method in Figure 3.2. Whereas, the Kantian/Hegelian perspective embraces the whole range of change from high change, characterised by Marxism, to low change, characterised by French Critical Theory.

Let us explore further the dimensions of Laughlin’s matrix, in particular, the diagonal from high/high (top left) to low/low (bottom right) in Figure 3.2. This diagonal is developed in Figure 3.3 with regard to the theory and methodological dimensions. As one moves from left to right in Figure 3.3 so it reflects these categories. It also makes them more transparent in that their content can now be assessed under six headings, top to bottom in Figure 3.3 (Laughlin, 2004, p272). The first two headings, top to bottom, relate to the theory dimension and the next four relate the methodological dimension.

**FIGURE 3.3: ALTERNATIVE RESEARCH APPROACH ASSUMPTIONS**

**\*ASSUMED GENERAL  
EMPIRICAL  
PATTERNS:**



According to Laughlin (2004, pp271-2)

“The sequencing and arrow flows [in Figure 3.3]...are intended to indicate the primacy of ontology and the links between this and the tendency to rely on prior theories. This is almost a duplicate of the original argument with its categorisation of ‘high’, ‘medium’ and ‘low’ use of prior theories yet, in this case, the descriptors are developed and amplified and the previous somewhat invisible links to underlying ontological assumptions are now made clearer. This ontological choice is seen as the foundation for all other choices that need to

be made. A decision on this guides, both directly and indirectly, the remaining choices about methodology and method. This linkage was not clear in Laughlin (1995)."

The starting point in Figure 3.3 is to choose one's position as regards the existence of prior theorising. The author shares Laughlin's (2004, p268) view

"...that accounting systems are not like gravity, and they are not totally divorced from underlying structures that traverse more than one setting. There are 'skeletal' rather than 'full' or 'no' theories which can explain accounting in practice or, more generally, any empirical phenomena. However these 'skeletal' theories need the richness of the empirical detail to make them meaningful in particular situations. There are structures that underlie social situations but not ones which fully capture the diversity and detail of these situations."

The 'underlying structures' in this thesis are those created by the regulatory process in accounting, specifically, the process leading up to the implementation of FRS10.

Given the skeletal structural characteristics of a Medium theory positioning one would have then naturally tended to adopt a critical discursive methodological approach as presented in Figure 3.3. Thus, one can offer a critical analysis of the existing accounting structures, which is indeed undertaken in this thesis. And if the research presented here had remained within the existing underlying 'skeletal structures' to accounting then one probably would have subscribed to this approach throughout. But, this thesis does not remain within the existing accounting structures, it seeks to both interpret them and reinterpret them. There are many ways of interpreting and reinterpreting data depending on one's perspective and as such this would tend to favour an interpretative methodological approach. An interpretative methodological approach is

"...directed at describing, translating, analyzing and otherwise inferring the meanings of events or phenomena occurring in the social world" (Covaleski and Dirsmith, 1990, p543).

The use of interpretative research here allows the researcher to examine the metaphorical aspects of accounting for intangible assets: the rituals, symbols and ceremonies so as to gain an understanding of values and norms of behaviour of those affecting and affected by

accounting. Thus, the proposed research approach is located as medium on the theory dimension and low on the methodological dimension. The two research methods, according to Figure 3.2, that fit this requirement are French Critical Theory and Structuration Theory. These two research methods are respectively underpinned by a Kantian/Hegelian and a Kantian/Fichtean philosophical perspective.

To repeat an earlier comment, with a 'Low' methodological choice the observer is permitted and encouraged to be free to be involved in the observation process completely uncluttered by theoretical rules and regulations on what is to be seen and how seeing should be undertaken. Thus, a number of ways of "seeing" are to be explored in the thesis: from a regulatory perspective, from a respondent perspective and from the author's perspective. As there is no one right way to "see", the Kantian/Fichtean perspective initially seems to be appropriate one for this thesis. This is because it is more effective in allowing the researcher to 'see' socially constructed intangible assets, which have yet to be seen or made material by accounting regulation. It then becomes a question of how one chooses to construct reality in this regard. To repeat, this view assumes a world whose existence cannot be divorced from the observer's perception of it, where generalisations cannot be assumed to exist and where understanding is subjective, specific and subjectively derived. In this world there is no basis upon which to judge the superiority of one interpretation over another and, therefore, any attempt to do so can only be advanced and subjectively justified on the basis that it produces a 'better' view of reality.

Given the chosen Kantian/Fichtean perspective one's research assumptions are, *prima facie*, located in the right-hand column of Figure 3.3. However, the logic of Figure 3.3 is based upon the aforementioned diagonal of Figure 3.2, in this case, Low theory/Low

method which, of course, excludes structuration theory located at Medium theory/Low method. Laughlin's answer to this situation is to take different routings through the variables depicted in Figure 3.3 but the flow arrows do not allow for this eventuality if one is to apply a literal interpretation of the diagram. But one does not need to apply a literal interpretation; one can, apply variations on the central theme presented in figure 3.3, such as that presented in Figure 3.4. Figure 3.3 can therefore be redrawn as Figure 3.4 and streamlined to accommodate this research stance.

**FIGURE 3.4: ALTERNATIVE RESEARCH APPROACH ASSUMPTIONS RELATING TO STRUCTURATION THEORY**

**\*ASSUMED GENERAL  
EMPIRICAL  
PATTERNS:**

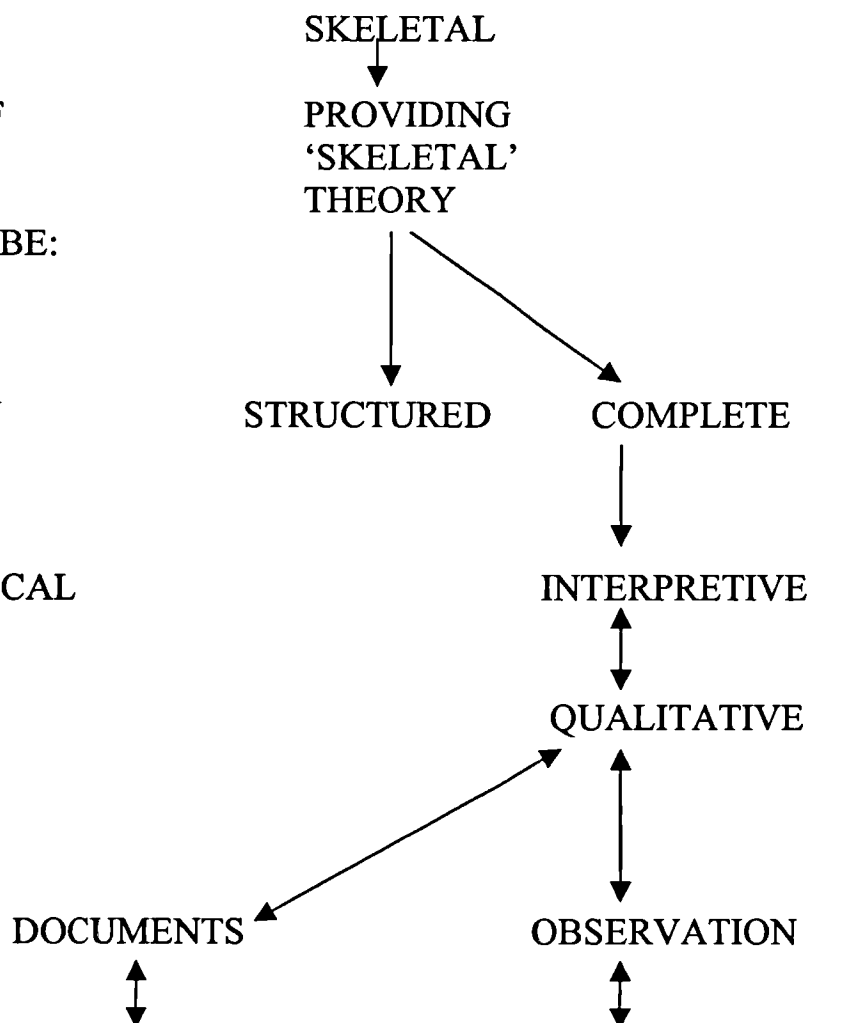
RELEVANCE OF  
PRIOR THEORY  
AT OUTSET OF  
RESEARCH: TO BE:

**\*ROLE OF  
OBSERVER/  
SUBJECTIVITY  
IN EMPIRICAL  
ENGAGEMENT**

METHODOLOGICAL  
APPROACH

DATA  
NARRATIVE

DATA  
COLLECTION  
METHODS:




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**ORGANISATIONS AND SOCIETIES MADE UP OF PEOPLE AND NON-HUMAN PHENOMENA**



There is an apparent conflict here with a methodological approach where the role of the observer is 'structured' within the existing accounting structures and also 'complete' where alternative structures are examined. However, Laughlin (2004, p274) says

"The distinction between 'complete' and 'structured' subjectivity is complex and should be seen more as a continuum even though there are some important distinctions being made. 'Complete' does not assume that this is some random process without constraints – interpretivists/constructionists have their own rigour with which they engage with the empirical world. It is rather that what constitutes the rigour cannot, in the final analysis, meaningfully, be analysed or spoken about distinct from the process of actual engagement. 'Structured', on the other hand, specifies in more precise and abstracted terms what is involved in this engagement process whilst, at the same time, not trying to squeeze out the intuitive, imaginative properties of individual observers."

Consider the following view on the merits of adopting the above dual approach. Baker & Bettner (1997, p306) comment:

"An important issue that often arises concerning the design of interpretive and critical research is whether it is appropriate to use a mixture of approaches in the same study. Some argue that certain methods are only appropriate to certain perspectives (for insight into this debate see Burrell & Morgan, 1979). Others have advocated a blend of research perspectives involving both qualitative and quantitative methods and interpretive and critical approaches (Miles & Huberman, 1984; Kirk & Miller, 1986). These blendings may merely be extensions of, and not alternatives to, mainstream perspectives and therefore should be viewed with caution (Tinker, 1995). We argue that it is important that the researcher's perspective be made clear so that the reader can understand and appreciate the context in which the research is being approached. It is this frank admission of the researcher's perspective which is virtually absent from mainstream accounting research."

Let us now consider the only research method which follows the assessment presented in section 3.1, namely Structuration Theory, as summarised from the works of Anthony Giddens (1976, 1979, 1984, 1987).

## **3.2. Structuration Theory**

### **3.2.1 Introduction**

Structuration theory seeks to provide an understanding of the relationship between the activities of knowledgeable human actors and the structuring of social systems. Giddens

argues that structures can be considered to be systems of generative rules and resources which, whilst existing outside time and space, nevertheless, provide the binding of time and space in social systems. According to Roberts and Scapens (1985, p446)

“...perhaps the best way to express Giddens’ distinction between system and structure is to say that systems are not structures, but rather systems *have* structures, which are produced and reproduced only through being drawn upon by people in interaction with one another. Through being drawn upon by people, structures shape and pattern (i.e. Structure) interaction. However, only through interaction are structures themselves reproduced. This is the ‘duality of structure’; it is in this way that structures can be seen to be both the medium and the outcome of interaction.”

Structuration theory presents two concepts: the ‘duality of structure’ and ‘structuration’.

With regard to the first concept, to repeat, the ‘duality of structure’ refers to the proposition that “the structural properties of social systems are both the medium and outcome of the practices that constitute these systems” (Giddens, 1979, p69). These structural properties comprise three dimensions, which are developed further in section 3.2.4. They are: signification (meaning), legitimation (morality) and domination (power).

With regard to the second concept, above, Giddens (1984, p376) defines ‘structuration’ as “The structuring of social relations across time and space, in virtue of the duality of structure.”

The structuring of social relations constitutes *social systems* whereby actors reproduce social practices often in routine manner but also, where required, in a radically different form.

The social practices that constitute a social system are bound together into social structures, which are drawn upon by actors in social interaction. However, it is only through social action (agency) and interaction that the social structures themselves are reproduced. Hence, the idea of duality of structure where social structures are both the

medium and the outcome of social interaction. Let us examine the notion of agency first (3.2.2) and social structures second (3.2.3).

### **3.2.2 Agency (social action).**

“Agency refers not to the intentions people have in doing things but to their capability of doing those things...Agency refers to doing...the consequences of what actors do, intentionally or unintentionally, are events which could not have happened if that actor had behaved differently” (Giddens, 1984, pp9-11).

Two important aspects should be stressed from this insight:

*Firstly, that actors act in an existential manner.* That is, in any circumstance and time, the actor could have acted otherwise either by deliberate intervention or passively in terms of forbearance (see Giddens, 1984, p56).

In any social setting it would be impossible for actors to consciously reflect upon every consequence of every social interaction. Therefore, actors often respond to social interaction in a reflexive manner, that is, using stocks of mutually shared knowledge not directly accessed at the conscious level of understanding. Thus, actors often behave in a routine manner as a matter of convenience, at times, unaware of some of the consequences of their actions, but always with the capability to rationalise their actions and to act existentially. Giddens argues that this reflexivity is conducted at two levels of consciousness: the discursive level and the practical level

At the discursive level of consciousness actors are able to use their linguistic skills to reflect upon their behaviour and provide reasons for it if pressed to do so. As Giddens (1984, p3) states

“To be human is to be a purposive agent who has both reasons for his or her activities and is able if asked, to elaborate discursively upon those reasons.”

At the practical levels of consciousness, actors respond by reference to an implicit stock of knowledge about how to behave in response to other actors. For example, as Giddens (1979, p25) states,

“...there is a vital sense in which all of us do chronically apply phonological and grammatical laws in speech, as well as all sorts of practical principles of conduct, even though we could not formulate those laws discursively (let alone hold them in mind during discourse).”

*Second, that in most actors there is an unconscious motivation for ontological security which conditions their behaviour.* Giddens based this viewpoint on the work of Erikson's (1963) developmental model of the infant's psyche. A child's psychological well-being is grounded in regular, reliable social relations with the mother and, later in life, in a preference for social action and interaction in situations that are predictable, stable and ordered. To some extent this explains why actors routinely reproduce social practices even though they recognise some of them as excessively coercive at times, for example, obeying a speed limit. Thus, the need for ontological security is a key element used by Giddens in the construction of agency.

### **3.2.3. Social structures**

Social structures are the social codes of conduct that guide and order our behaviour in social settings. They can be partly deterministic in that conduct is motivated by antecedent causes, such as when an outstretched hand precedes a formal greeting. Much more likely is that these codes of conduct remain abstract in nature. Over time they can order and bind similar social practices. However, they can and do change, particularly as organs of society or society as a whole change, sometimes slowly sometimes radically. For as Giddens (1976, p102) argues

“...the key to understanding social order...is...the shifting relations between the production and *reproduction* of social life by its constituent actors. *All reproduction is*

*necessarily production* however, and the seed of change is there in every act which contributes towards the reproduction of any “ordered” form of social life.”

Insofar as such codes of conduct can be said to exist given their abstract nature, they exist independently of any particular actor. They are structures that exist in virtual time and space and can be accessed by actors in an instance during social interaction in specific time/space settings. Yet, at the same time, there is seldom anything permanent about these structures which are the product of human invention and reinvention as social situations change. So, for example, accountants have traditionally been expected to exercise prudence in their reporting of financial matters. This would be a feature of their professional conduct that would typically apply to most of them wherever situated and regardless of any supporting accounting standard, such as SSAP2 (ASC, 1971). It could be argued that this is a structural characteristic of the current maintenance of social order from an accountancy perspective. Yet, one can also subsequently observe in FRS18 a subtle change from the concept of prudence to the concept of reliability of measurement. Thus,

“...the deliberate understatement of assets and gains and the deliberate overstatement of liabilities are no longer seen as a virtue. Accordingly, like the *Statement of Principles*, the FRS treats prudence as one aspect of the overall objective of reliability” (ASB, 2001, p52).

What matters however from Giddens viewpoint is the centrality of actual practice (or agency – see section 3.2.2, previously) and the interplay of social structures and actual practice by knowledgeable actors. In respect of the above example, FRS18 may or may not be an influence in this process. The attraction of Giddens’ approach is that it provides a method of analysing actual practices, in this example, accounting practices, within a framework that acknowledges the interdependent characteristics of ‘social structures’ and ‘social systems’.

In distinguishing his view of social system from a systems theorists viewpoint, Giddens (1984, p377) expresses 'system' as

"...the patterning of social relations across time-space, understood as reproduced practices. Social systems should be regarded as widely variable in terms of the degree of "systemness" they display and rarely have the sort of internal unity which may be found in physical or biological systems."

In contrast, systems theorists argue that by analysing systems they can abstract concrete social practices. In effect, individual actions are produced or determined by society.

According to Roberts and Scapens (1985, p445)

"...such a belief underlies...the narrowly technical and prescriptive character of much of accounting research. The purposes of accounting systems are often conceived in terms of an unambiguous and uncontested set of organisational objectives or imperatives, and it is assumed that once designed, the accounting systems will directly determine what people do."

An alternative, interpretative viewpoint to a systems theory approach presents a view of the individual actor as the producer of social reality. In this regard, organisations simply provide a context in which social action and interaction takes place. Both viewpoints, however, distinguish between the individual actor and society. It is a dualistic approach that separates subject and object, respectively. Instead of this separation, Giddens advances the case for 'duality of structure' in which the relationship of social structure to social interaction is described in the form of a dialectic where they presuppose one another.

#### **3.2.4 The dimensions of structuration**

Social structures possess three dimensions: signification (meaning), legitimation (morality) and domination (power) and the three dimensions are linked. Roberts and Scapens (1985, pp448-450) refer to the example of 'accounting as a language' to illustrate the differences between these three dimensions. Accounting terms such as cost, income, profit, return on

investment etc. serve as a structure of meanings which can be drawn upon by actors to order and orient their actions. Because these meanings are always contestable and negotiable they condition rather than determine accounting practice. As such, the structure of meanings are themselves constantly evolving and changing. Thus, for example, what may be regarded as an intangible asset for accounting purposes (indeed, any socially constructed asset) is unlikely to be fixed in time and space. In addition to the production and reproduction of meaning, accounting practice provides for a moral ordering of reciprocal rights and obligations: to communicate a set of values, to establish norms of behaviour and, with them, indications of what is approved and disapproved, generally, to hold others to account. Budgetary control is an obvious example in this regard. With the legitimacy afforded to accountants to hold others to account goes the whole range of sanctions from reward to dismissal. In other words, attached to the accounting analysis of action is the power to instigate change. Typically, the exercise of power is open to negotiation and differential interpretation, but it is also the power of the superior to dominate the actions of the subordinate where appropriate. However, perhaps the real power of accounting is the ability to structure meanings such that accountants are able to create a version of business reality for others to follow. Specifically, it is the ability to influence, maybe even directly, what shall or shall not count as being significant for control purposes in an organisation. Let us look at these dimensions sequentially in more detail.

### *Signification (meaning)*

Signification creates meaning in social interaction. Meaning refers to the “intelligibility” of social interaction (see Giddens, 1976, p78). Meaning conveyed by social interaction is contained by the category of communication, notably:

(a) '*communicative intent*' or passing on information. In the broadest sense of the term 'intent', Giddens (1976, p105/6) comments "in everyday situations of interaction the will to speak is also sometimes the will to baffle, puzzle, deceive, to be misunderstood...Humour, irony, and sarcasm all in some part depend upon such open possibilities of discourse, as recognized elements of the skills whereby interaction is constituted as meaningful."

(b) '*indexical difference*' where "actors sustain the meaning of what they say and do through routinely incorporating 'what went before' and anticipations of 'what will come next' into the present of an encounter" (Giddens, 1979, p84).

According to Giddens (1979, p85) it is

"...the interplay of meaning as communicative intent, and the meaning as difference, represents the duality of structure in the production of meaning".

Meaning at the level of social interaction is linked to the theory of signification at the level of structure:

"...codes provide the rules which generate signs as concrete occurrences in communicative intercourse...in social interaction the messages are always 'texts' in the sense in which they are generated from, and express a plurality of codes" (Giddens, 1979, p106&99).

Common examples of signification structures would be verbal language, sign language or braille. The structure is provided, respectively, by words, symbols and dots which are organised so as to provide a vocabulary. Actors can then draw upon this vocabulary using the rules and syntax of language in order to create understanding and convey meaning to others in any social setting. The rules and syntax of language are what may be referred to as 'interpretative schemes'.

"By 'interpretative schemes', I mean standardised elements of stocks of knowledge, applied by actors in the production of interaction... 'Interpretative schemes' are the modes of typification...whereby they are able to make accounts, offer reasons, etc." (Giddens, 1979, p83; 1984, p29).



Interpretative schemes mediate between the (virtual) structure and the (situated) social interaction – what Giddens refers to as “modalities of structuration” (Giddens, 1984, p28).

In the above case, between the organised words, symbols and dots, and the communication of meaning to others through speech, signing and writing, respectively. But it is also important to comprehend that the rules and syntax of language are dynamic and are themselves the outcome of individual acts of communication. Thus, interpretative schemes depend and draw upon a signification structure and, at the same time, reproduce that structure.

Macintosh and Scapens (1990, p460) provide an example of these modalities of structuration by reference to management accounting systems. They state

“...management accounting provides managers with a means of understanding the activities of their organization and allows them to communicate meaningfully about those activities. As such, a management accounting system is an interpretative scheme which mediates between the signification structure and social interaction in the form of communication between managers. The signification structure in this case comprises the shared rules, concepts, and theories which are drawn upon to make sense of organizational activities. They include the various notions of finance, economics, management science etc., as well as accounting concepts, such as income, assets, costs, revenues and profits.”

The aforementioned codes and rules have signification prior to the application of any interpretative scheme. The subsequent application of the interpretative schemes presupposes that the social actors have a shared understanding of the meanings conveyed by it. At times that can be problematic, for example, where the ‘language of business’ created by accountants is viewed by some as meaningless ‘accountancy jargon’.

### *Legitimation*

Turning now to the legitimation structure, it refers to the moral constitution of social action. Morality, according to Giddens (1979, p86, brackets added) is grounded on the concept of the “double contingency” of social interaction:

“...the reactions of each party to a process of interaction depend upon the contingent responses of the other or others [so that] the response of the other(s) is...a potential sanction upon the acts of the first and vice versa.”

According to Macintosh and Scapens, (1990, p460)

“It comprises the shared sets of values and ideals about what is to be regarded as virtue and what is to be regarded as vice; what is to be counted as important and what is to be trivialised; what ought to happen and what ought not to happen. As such, the legitimation structure institutionalises the reciprocal rights and obligations of the social actors”.

Legitimation structures are mediated through accepted norms and moral codes of behaviour, which actors draw upon in social interaction. These norms and moral codes of behaviour define the mutual rights and obligations of actors across a wide range of social settings.

The norms and moral codes of behaviour maintain a degree of social order in that they inculcate values into the minds of individuals such that there is often a high degree of fit between the individual and the collectivity. However, when considering such ‘high degree of fit’ one should comprehend that moral obligation does not necessarily imply moral commitment because norms can be approached in a “utilitarian fashion” (see Giddens, 1976, p108/9, brackets added). For example,

“...systems of accountability...embody a moral order: a complex system of reciprocal rights and obligations. The practice of accounting institutionalises the notion of accountability: it institutionalises the rights of some people to hold others to account for their actions. Viewed in this way, the practice of accounting can be seen to involve the communication of a set of values of ideals of expected behaviour [norms, above], of what is approved and disapproved. The practice of accounting involves communicating notions

of what should happen, and it is only on the basis of these notions that sense is made of what has happened” (Roberts and Scapens, 1985, p448, brackets added).

The implication is that there is some form of moral consensus in a social system such that there is a shared set of values as to what may be regarded as important to the collectivity. Cohen (1989, p42, brackets added) points out that rules have an important role to play in this regard because they help to establish the practical routine of compliance with the norms of the collectivity. Rules can persist for some considerable time in the history of a collectivity:

“Giddens’ most significant contribution in the duality of structure is to treat rules regarding aspects of institutionalised conduct as structural properties of social collectivities” [where] “rules...appear as generalizable aspects of procedures that are drawn upon in the reproduction of regularities of social *praxis*”

Whilst the possibility of change is inherent in every act of social reproduction, Scapens and Macintosh (1994, p682) argue that “if there is to be any continuity to social life, there must be established routines and institutionalized conduct.” Clearly, rules have a part to play in establishing such routine conduct.

The implication is that there is shared meaning and a shared value system at play brought about, in part, by compliance with rules. However, it was a position rejected by Boland (1993, p126):

“Viewing meaning at the institutional level leaves little hope for seeing the individual actor engaging in the responsible creation of meaning so central to structuration theory.”

Boland (1996, p692) was very sceptical about the notion of shared meanings accusing Macintosh and Scapens (1990) of imposing “...institutionalized, monolithic sets of meanings...i.e. whole, seamless and uniform” (see Boland, 1993, p140 and 1996, p692, respectively). He argued:

“In their analysis, Giddens emphasis on the reflexive monitoring of conduct in situated practice is replaced with the idea of coherent understandings and intentions that are shared by actors and the use of those shared meanings as an explanation for social action and institutions. In developing structuration theory, Giddens was, among other things, trying to dislodge just this idea...”(Boland, 1996, p693).

In trying to determine the shared meanings attributable to goodwill and intangible asset rules a similar criticism could perhaps be levelled at this thesis. The above two positions appear to be presented in mutually exclusive terms. Yet, it is possible to have shared meanings through *de jure* acceptance of the rules and still have individual accounting actors acting contrary to it (*de facto* ‘bending’ of those rules), brand accounting being a case in point. Nor does the difference between the actions of social actors necessarily need to be polarised in terms of those who share a meaning and those who do not. So, for example, ED52, an accounting rule, disapproved of the capitalisation of brands. In practice, this rule was adopted and shared by the overwhelming majority of the collectivity. It became the behavioural norm. Yet, those accounting actors who capitalised brands on the basis of an independent valuation, sometimes outside the signification structure to be presented in this thesis, would argue that any brand valuation was constrained by the total transactions-based amount of goodwill, inside the signification structure – as we shall see, the latter position being shared by the collectivity. Thus, it may be argued that there were some actors who only part-share in the actions of the collectivity and this, speculatively, must surely be the case for many accounting actions where self-interest or company interests dominate.

Where accounting actors appear to act outside the existing normative rules, other social actors are entitled to ask: “what are they doing?.” A narrative may then be constructed as to their intent, a narrative that is formulated against a social setting which makes the intent understandable to other actors. The intent of the accounting actors and the social setting

intersect in a specific time-space location. It follows that any moral judgement on the actions of such actors is contingent on the historical social setting in which it takes place. This may be interpreted narrowly, as for example, within the context of the FRS10 consultation process, or broadly, as for example, within the context of the standard setting role of the Board. The moral obligations arising from both perspectives are explored in this thesis with emphasis being on the latter stance.

The possibility of sanction plays a key role in the fulfilment of moral obligations. For example, accounting actors risk the sanction of a qualification to the published accounts through regulatory non-compliance. Giddens (1976, p109/110) refers to two types: positive (reward) versus negative (punishment) sanctions and, internal versus external sanctions. In this latter regard, internal sanctions “involves elements of the actor’s personality” whilst, external sanctions “draw upon features of the context of action”. In practice, various sanctions “may operate simultaneously”, also, “no ‘external’ sanction can be effective unless it brings into play an ‘internal’ one.” It is sanction at the level of social interaction that links the theory of ‘legitimation’ at the level of structure.

### *Domination (power)*

This dimension refers to the ability to get things done: “the transformative capacity of human action” (Giddens, 1976, p110). The exercise of power does not need to be entirely authoritative. There can also be a relational or ‘domination’ aspect to it. For example,

“...it is an accepted fact of political life that those who occupy formal authority positions are sometimes puppets who have their strings pulled from behind the scenes. It is in the hidden processes of control that some of the crucial operations of power in modern societies are located” (Giddens, 1977, p345).

The exercise of power is related to asymmetries in the distribution of resources, that is, allocative resources and authoritative resources. Allocative resources refers to control over material resources, whereas, authoritative resources refers to the capacity to organise and co-ordinate the activities of social actors. Macintosh (1994, p175, brackets added) provides an example of the use of allocative resources in the use management accounting systems:

“...management accounting and control systems are vitally involved in relations of domination and power. Command over them is a key allocative resource used by upper-level executives to hold dominion over the organization’s physical and technical asset. The master budget, for example, contains the detailed and all-encompassing blueprint for resource allocation for the entire organization and is a powerful lever in terms of ability to make a difference, to get things done, and to dominate the organization.”

Allocative resources in an accounting context typically relate to property rights, even for intangible ones, for which there is often a recognisable artefact. In contrast, authoritative resources refer to the power to co-ordinate and control things and people within social settings for which it is axiomatic that there is no recognisable artefact. To summarise:

“Allocative resources refer to capabilities...generating command over objects, goods, or material phenomena. Authoritative resources refer to types of transformative capacity generating command over persons or actors” (Giddens, 1984, p33).

According to Giddens (1979, p149)

“...all power relations are reciprocal: however wide the asymmetrical distribution of resources involved, all power relations manifest autonomy and dependence ‘in both directions’.”

In this way, actors can exercise power themselves in social interactions with those who seek to dominate them through a particular domination structure -- what is referred to by Giddens as the dialectic of control.

“By the dialectic of control I mean the capability of the weak...to turn their weakness back against the powerful” (Giddens, 1982, p39).

Giddens argues that even in the highest repressive forms of collectivity or organisation, such as a prison, the dialectic of control still operates.

“Anyone who participates in a social relationship...necessarily sustains some control over the character of that relationship or system...actors in subordinate positions are never wholly dependent...To be an agent is to have the capability of ‘making a difference’...Only a person who is kept totally confined and controlled does not participate in the dialectic of control. But such a person is then no longer an agent” (Giddens, 1982, p198-199).

According to Macintosh (1994, p176)

“...the dialectic of control is connected to a social system’s primary contradiction, an essential aspect of the constitution of any social system. This is not so much a logical contradiction as a contradiction in the sense that some basic “ structural principles operate in terms of one another but yet also contravene each other” (Giddens, 1984, p193). Each depends on the other while at the same time negating the other. The antinomy between the two basic structural principles is an intrinsic aspect of the social system in that the tension between them is basic to its system integration.”

For example, a capitalist system creates the structural principle that affords the individual owners of capital the right to appropriate surplus wealth created by the system. At the same time, this appropriated wealth is actually created by other members of society. As such, the capitalist system is intrinsically contradictory in that

“The very operation of the capitalist mode of production (private appropriation) *presumes* a structural principle which negates it (socialized production)” (Giddens, 1984, p142).

The exercise of power inevitably brings one into conflict with those actors holding a contrary view to one’s own view. However, Giddens stresses that “the relation between power and conflict is a contingent one” (Giddens, 1976, p112). He states:

“It is the concept of ‘interest’, rather than that of power as such, which relates directly to conflict and solidarity. If power and conflict frequently go together, it is not because the one logically implies the other, but because power is linked to the pursuance of interests...while power is a feature of every form of human interaction, division of interest is not.” (Giddens, 1979, p94;1977, p348; 1976, p112).

Let us briefly look at this contingency in the accounting context of intangible asset recognition and disclosure.

Power (1992, p15) states:

“If what ‘accountants are currently prepared to recognise’ is a contingent matter, then any attempt to shift the consensus of accepted practice is political... This political process is necessarily conducted in the technical language of recognition, separability and valuation, the ‘how’ of asset measurement, but it is also as much a matter of ‘who’ is promoting such innovations and their relation to existing bodies of knowledge”.

The ‘who’ in this thesis is multifaceted in that, on one hand, the dominant authoritative power clearly rests with the ASB. On the other hand, there are those interested parties inside the profession and outside it (notably brand valuation companies, those conglomerates who originally opposed ED47, as well as certain marketing and legal interest groups) who seek to undermine and/or overturn the ASB’s regulatory stance towards intangible assets. A power struggle develops between these competing interests, where the Board’s power to legitimise the existing signification structure is under threat by those who would seek to change the status quo to their own advantage.

### **3.2.5. A critique of structuration theory and the central role of power**

The origins of structuration theory can be traced to Giddens’s perceived deficiencies in the structuralist/functionalist and hermeneutical/phenomenological schools of sociological thought, for example and respectively, functionalism, with its emphasis on social structures, he accuses of being “strong on structure, but weak on action” (Giddens , 1976, p4). Whereas, the opposite is the case in respect of the latter school of thought focused principally on social action. It is through his notion of the “duality of structure” that social structure and social action are brought together in recursive cycles where the one presupposes the other. However, there are critics who would question whether social



structure is produced and reproduced entirely on the basis of social action and the freedom of the individual to do otherwise. Harré (1983), for example, suggests that highly structured organisations, such as monasteries, are so rule-driven in the daily conduct of social action as to make redundant the recursive cycle of production and reproduction because the freedom to do other than in respect of the rules is effectively denied to the individual actor. Storper (1985, p419), for example, argues that there may be a “differentiated (and thus limited) topography for the exercise of agency rather than an endlessly recursive plain”.

It was a concern shared by the author, for example, in respect of the recursive cycles of consultation that began with the ASB’s discussion paper (ASB, 1993) and ended with the publication of FRS10 (ASB, 1997), whereas, other cycles, such as the interaction of social actors with transactions-based financial reporting structures, appear to be endlessly recursive in nature.

Another reservation concerning structuration theory centres upon the conflation of social structure and social action, that is, where structure is reduced to action. So, for example, acts of accounting arbitrage in the context of this theses can be seen in terms of the social action of exploiting the structural weaknesses of goodwill accounting, or, structurally, as a means of highlighting the flexibility of the existing social structures themselves, or, perhaps, both together. Archer (1996) argues that conflation weakens the analytical power of structuration theory because the distinction between the parts of society and its people is vital for its ontological grounding as a theory, one that seeks to explain why things are structurally so and not otherwise. Her focus, therefore, was upon “outcomes”, specifically in answering “why do some forms of social reproduction succeed and become institutionalised, and others do not?”. The author shares that focus, for example, why did

impairment become “institutionalised” as part of FRS10 when, as we shall see, there was initially a sizeable majority of respondents against that policy choice. That said, any implication of priority being given to any aspect of the recursive cycles, including that aspect concerning of ‘outcomes’, would be rejected here – all aspects being integral to the overall analysis.

An important aspect of Giddens’s understanding of social structure is that it is a virtual ordering of social action produced and reproduced in a specific time/space location. It follows, that social structures do not exist in material artefacts even though material or “allocative” resources may have been be applied to make them appear real (as when an intangible asset is trademarked, patented, etc or when institutional structures are represented in terms of logos, buildings, codes of conduct, etc). That said, Storper (1985, pp420) argues that

“the *durée* of the material, although not imposing absolute constraints on system change, does mean that at any moment not everything is possible.”

The production and reproduction of practices that constitute Giddens’s virtual order implies that social actors are aware of their engagement in the process of creating, maintaining or changing social structures, which has previously been explored in terms of practical and discursive levels of consciousness. This leads to a “double hermeneutic” whereby the virtual order of a social structure is already constituted in the minds of individual social actors as meaningful and therefore becomes an element of the actor’s understanding of their own condition. This has led to a criticism that the double hermeneutic inappropriately precipitates a voluntaristic view of human agency (see Bhaskar, 1979). The overwhelming compliance with FRS10, highlighted by the longitudinal survey, could be argued as being supportive of this viewpoint. Yet, at the

same time, “the seed of change is there in every act which contributes towards the reproduction of any ‘ordered’ form of social life” (Giddens, 1976, p108), for example, in respect of recent ‘new converts’ to the minority practice of brand accounting (see appendix A).

A criticism of structuration theory presented by Gregson (1989) is that it operates at too high a level of generality to be able to provide guidance on empirical work. Thus, a criticism related to this thesis is that the structural principles of structuration theory are too general because they, for example, accommodate an engagement with the research site that can be both structured (typically associated with critical approaches) and complete (typically associated with interpretive approaches) at the same time. In other words, the positioning of structuration theory on the ontological spectrum is, perhaps, too broadly based albeit towards the phenomenological end of the spectrum. The danger is that, as a theory, it sits on top of the ontological spectrum rather than being located at a point on it. Consider also the comments of Rose (1998, p7, brackets added):

“The lack of a concrete empirical example in his own work [ie.Giddens], together with its abstract conceptual focus similarly offers few clues as to how to proceed in the everyday world in the gathering of useful understanding, and its reflection back into the world of practice.”

However, in using the precise positioning offered by the use of the Laughlin matrix (see Figure 3.3), that argument is rejected in this thesis. Also, Giddens (1984, p281-284) himself attempts to defend against the above criticism by asserting the key features of structuration as “guidelines for the overall orientation of social research”:

1. Social actors are knowledgeable agents

2. Their knowledge is bounded by, on the one hand, the unconscious and, on the other hand, by the unacknowledged conditions and unanticipated consequences of social action.
3. The reproduction of institutionalised practices is integral to structuration.
4. Routine is the predominant form of day-to-day social action (ontological security)
5. The study of context is inherent to the study of social reproduction.
6. Social identities and related social practice are 'markers' in the virtual time-space structure.
7. No single meaning can be given to 'constraint' in social analysis.
8. The structural properties of a social system are important because they specify the overall types of society.
9. The study of power cannot be regarded as a second-order priority (an issue to be developed later on)
10. The interaction of social structure and social action in one social setting may be emulated by others in another social setting.

Hence, the phrase already used in this thesis is that structuration theory is used as a "sensitising device":

"Structurational approaches are then a sort of theoretical galaxy which will "sensitise" the researcher to some important aspect of the social phenomena under study, and which will help her/him to give a minimal coherence and relevance to her/his conduct" (de Vaujany, 2004, p2)

However, the alternative ways of putting it are that structuration is "fundamentally non-propositional" (Archer, 1990) or that it is "second-order theory" (Gregson, 1989, p245) or that "it does not give us anything to test or find out" (Craib, 1992, p108) or "that structuration is best considered as a meta-theory, a way of thinking about the world rather than as an empirically testable explanation of social behaviour" (Jones and Karsten, 2003,

p17). In the context of this thesis the author has tried to overcome some of these criticisms, for example, by establishing a hypothesis as a guiding framework even though it would not be tested in the empiricist tradition. Also, by setting up the thesis in this manner it is possible to say whether a specific issue (eg. attitudes to impairment) are confirmatory or not – in other words, a positively reinforcing or a negatively reinforcing recursive cycle of social structure and social action. And, in order to minimise the criticism of bias, wherever possible the use of structuration theory has been grounded ‘other people’s views’ as evidenced by the extensive number of quotations in the thesis.

Turning now to the issue of power, the duality of structure concerning domination (social structure) and power (social action) could be said, to some extent, to be derived from the Hobbesian and Machiavelian viewpoints. Hobbes focused upon the sources of sovereign power from which authority was derived (a structuralist approach directed towards gender, ownership etc) whereas Machiavelli was focused on the attainment of power (an agency approach directed towards strategy and practical concerns). This apparent dichotomy is, nevertheless, brought together in Giddens’s work, where the linkage of power to the duality of structure is expressed in the following terms:

“‘Power’ intervenes conceptually between the broader notions of transformative capacity on the one side [social action], and domination on the other [social structure]: power is a relational concept, but only operates as such through the utilization of transformative capacity as generated by structures of domination” (Giddens, 1986, p93, brackets added).

“Although in the sense of transformative capacity power is implied in the very notion of action, I shall henceforth employ the term ‘power’ as a sub-category of ‘transformative capacity’ to refer to interaction where transformative capacity is harnessed to actors’ attempts to get others to comply with their wants. Power in this relational sense, concerns the capability of actors to secure outcomes [see Giddens, 1982, p38] where the realisation of these outcomes depends upon the agency of others”(Giddens 1986, p93, bracket added).

It is important to emphasise that the exercise of power in this context is exercised in a “relational sense”, that is,

“...involving reproduced relations of autonomy and dependence in social interaction” (Giddens, 1986, p39)

which should be distinguished from the exercise of power that arises under other conditions, such as conflict,

“...as in the Weberian definition which seems to imply that power only exists, or is only exercised, when the resistance to others has to be overcome...” (Giddens, 1986, p94).

Thus, “the very notion of having power implicitly refers to other people” (Elster, 1976, 252) which, in the context of this thesis, is centred upon the relative transformative capacities of the ASB and respondents alike. Hence, power is seen as being bounded by observable behaviour, in this case, from an analysis of established texts. The observation is primarily directed towards an understanding of the exercise of political power, specifically, collectively binding decision(s), or not, as the case may be. The observation-based approach adopted here is therefore located in a decision-making or action-based concept of power, that is, in the positive or negatively reinforcing recursive ‘cycles’ of the duality of structure. In this context, resistance to the exercise of power, as with a negative recursive cycle, may

“..be relevant in the sense that, if it is actualised, it provides the test by which one can measure relative power, where parties conflict over an issue” (Lukes, 1986, p2),

The observation/decision-making approach, therefore, offers a degree of methodological clarity even if one has reservations about the actual operation of the duality of structure.

However, it is, perhaps, also fair to say that this approach only offers a “one-dimensional view of power” (Luke, 1974, p11). Let us consider other dimensions.

Another way of exploring the issue of power in the context of this thesis will be to highlight what was not included in the process of consultation that took place between the Board and the respondents to the implementation of FRS10. As, Holmes (1988, p22) comments:

“...organizations and collectivities can leave selected topics undiscussed for what they consider their own advantage.”

Bachrach and Baratz (1970, pp43-44) refer to this non-decision making exercise of power as the “the primary method for sustaining a given mobilization of bias.” This “two dimensional view” (what is included as well as what is excluded from the texts) attempts to show the “potential issues which nondecision-making prevents from being actual” (Lukes, 1974, p16, p19), a good example, being the existing bias associated with the disclosure of purchased intangibles and the non-disclosure of comparable internally generated intangibles, as explored in Chapter 2. However, in making this assertion about a biased regulatory construction of financial reality two assumptions are implied, first, that nondecision-making is a conscious act whereas it may simply be an unconscious one. Whilst that may be the case it should also be understood, in terms of the research approach adopted here, that an unconscious act effectively rules out the notion of ‘structural power’ because the relational power context implicit to structuration theory is removed. For Giddens (1986, p91):

“...power must be treated in the context of the duality of structure: if the resources which the existence of domination implies and the exercise of power draws upon, are seen to be at the same time structural components of social systems.”

Second, that the respondents appear to lack the resources to change any bias that may be presented in the Board’s regulatory construction of financial reality including any omissions from it, consciously or otherwise. Yet, we know from historical events, such as the SSAP16 Current Cost debacle, that under certain circumstances the accounting

collectivity does possess the resources to overturn the Board's (or rather the ASC's) construction of financial reality. In other words, whilst the asymmetries of resources employed in the sustaining of power relations in and between systems of integration are a vital feature in the maintenance of a domination structure (see Giddens, 1986, p93), this does not, indeed, cannot, suppose that the domination structures to be presented in this thesis are completely under the Board's control (reference the dialectic of control). The implication of both points is that nondecision-making is always viewed as a conscious act of exercising power.

Finally, another aspect of power refers to the reduction of "cognitive dissonance" (Elster, 1983, p110, p116) through the ideological indoctrination of accountants (education and training) and the subsequent limiting of capacity in the way they view and construct their portrayal of financial reality. In the context of this thesis, an example would be the innate preference for asset recognition on the basis of transactions-based cost even though there may be a legitimate opportunity to recognise an asset on an alternative measurement basis, for example, as a valuation extracted from purchased goodwill. In contrast, an increase in cognitive dissonance arises from a failure to satisfy the needs and wants of accounting actors despite such indoctrination, for example, in the 'need' to disclose brand valuations. The perpetuation of limited capacities lies in "their hidden ubiquity being their protective camouflage" (Hyland, 1995, p210), in this case, the "ubiquity" of maintaining transactions-based cost and the "protective camouflage" it affords in avoiding the unreliability of intangible asset valuations. Perhaps, being aware of this situation and in seeking to overcome some of its effects from a disclosure viewpoint, the IASB recently sought to include in IAS38 (2004, para 35) the following terms:



“...a *rebuttable presumption* that the fair value of a finite-lived intangible asset acquired in a business combination can be measured reliably” (see also IFRS3, 2004, para BC102(b), emphasis added),

thus removing the above protective camouflage by reversing the former shared presumption of ‘unreliable’ valuations under such circumstances (see appendix A). That said, although the shared beliefs brought about by an accounting indoctrination are typically manifested in compliant social action there is no real exercise of power to that effect – the rulers rule by default rather than by fiat. As a result, perhaps what we are really taking about here is an instance of structural domination on what should constitute a true and fair view of financial reality and how to minimise variation in the way that view should be disclosed in practice. Also, the above situation may be a reasonable example of how easy it is to conflate social action (power) and social structure (domination): is the reduction of cognitive dissonance the result of the social action of accountants or their regulatory social structure or both at the same time?

The above critique does not negate the use of structuration theory so long as its limitations are known. It is a particularly useful tool when considering the power dynamics of the FRS10 consultation process addressed in this thesis. However, the important point is that these dynamics are not explored in isolation of the tripartite structure outlined individually in the previous section. For example, as will be shown in the chapter seven summary, the exercise of power during the FRS10 consultation period was undertaken against a background of an unchanging signification structure and a legitimation structure that did not necessarily operate on the basis of a majority opinion. More on those points later on, the point here is that the structuration approach is a useful one to adopt because of its integrative nature and, therefore, more comprehensive analysis of the subject matter under investigation.

### **3.3. Positioning the research approach in relation to Laughlin's matrix - Figure 3.1**

Let us now briefly examine in broad terms how the theoretical analysis presented in sections 3.1 and 3.2 may be applied to the practical situation of analysing the regulation of accounting practice in respect of intangible assets.

Prior theorising on the subject of goodwill and intangible assets is structured according to the skeletal framework of structuration theory: signification, legitimation, domination. Whilst well researched in previous studies (see chapter two), the accounting perception of goodwill and intangible assets in the material world, the world of financial reporting, is, nevertheless, not founded on well-developed theories. There may be high levels of generality in terms of accounting practice but not necessarily in terms of the theoretical foundations to such practices. This is mainly because of the accounting dependence on a defined reality which, by its nature, constitutes an inherently subjective social construction. As such there is social structure but also considerable latitude in the way that structure may be interpreted. Hence, a 'medium theory' positioning was adopted on Laughlin's matrix (Figure 3.1).

From the Kantian/Fichtean perspective, if the observer perceives the existence of something which by nature is not physical, nor visible, it nevertheless exists in his/her world. Similarly, a Kantian/Hegelian perspective on reality would not exclude most intangible assets where, for example, they enter into ones perception and become 'material' through accounting practice. Though often synonymous with each other one does need to be careful about confusing the 'material world' with a 'tangible world'. In fact, any accounting transaction, whether capitalised or not, could be

said to be part of the material world. The difficulty arises where, according to a Kantian/Fichtean perspective, an intangible asset is perceived to exist but has yet to enter the material world as “mediated and moulded” by the accounting profession’s view of whether it should be identified, or not, initially according to some definition.

This way of ‘seeing’ opens up two distinct possibilities. One can adopt the accounting way of seeing and then apply a critical research perspective within that socially created structure. Alternatively, one can adopt a way of seeing which is unconstrained by any accounting structure. Thus, one can adopt an interpretative approach and thereby interpret and reinterpret what is seen initially from within the accounting domain. In the first instance the approach of the researcher is structured and in the second instance above, the engagement of researcher with the research site is complete (see Figure 3.3). However, there is a third way of seeing which is to blend the above two approaches. Let us consider that approach next.

Methodological rigour is introduced through the use of structuration theory. It is applied to the accounting way of seeing, specifically, to the Board’s various papers and the responses to them leading up to the implementation of FRS10. The research method is useful in providing skeletal rules for the process of discovery whilst leaving the researcher free to highlight the strengths and weaknesses between the social structures created by this process and those who created and responded to them. The problem here is that there is a thin dividing line between critical comment on what is observed from the process of discovery and critical comment which goes beyond that which is observed to embrace what may be interpreted and reinterpreted by the researcher from the examination of the various papers. For example, there was unavoidable bias in the selection of those views of

the respondents to the FRS10 consultation process from the mass of data being analysed, also, in the interpretation of language with all the attendant ambiguities attached to ones interpretation of what was said and written. The difficulty of maintaining sufficient detachment from the research data was therefore a problem inherent to the research site itself. So, whilst the research method was guided by a skeletal structure the involvement of the researcher was also unavoidable. It is for this reason that a 'Low' method positioning was adopted in Laughlin's matrix.

Finally, let us address the change dimension on Laughlin's matrix. There is no contradiction here in that a Kantian/Fichtean philosophical perspective is associated with Low levels of change – see Figure 3.2 – to be adopted here.

To summarise, the research presented in this thesis is positioned as Medium theory, Low method and Low change on Laughlin's matrix.

### **3.4. A concluding comment**

Structuration Theory is not a theory in the empiricist tradition but it is a structured way of making sense of social life and a sensitising device for researchers. The structuration approach adopted here regards accounting not as a natural phenomenon, but as a social construction located in a social context. It helps to explore the extent to which it is conditioned by the wider socio-economic system, for example, by brand valuation companies and certain persons inside accounting who conflict with the establishment line.

A central feature of the empiricist tradition is the creation of a hypothesis, which, if proven, may yield generalised theories. This is not possible with Structuration Theory

because social theorists are part of the very phenomena they study and consequently part of the theories they produce. Any attempt to generalise has the potential to influence the social theorist's understanding of the context of their action and thereby undermine itself.

It is therefore not possible to construct any permanent theory of social behaviour.

Notwithstanding these comments, a general hypothesis has been presented in chapter one as a means of providing an overall focus to the thesis. It is not intended that this hypothesis should yield any generalised theories about goodwill and intangible assets. It does, however, provide a powerful analytical framework for understanding the underlying factors guiding specific social actions and their outcomes.

## Chapter four – Signification

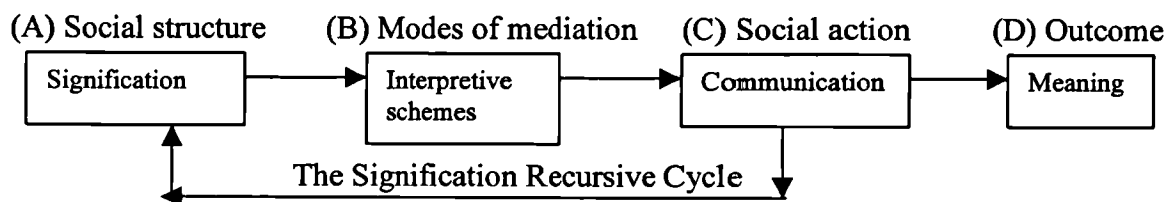
### 4.0. Introduction

According to Macintosh (1994, p172):

“Signification is the abstract cognitive dimension of social life whereby agents communicate with and understand each other.”

As can be seen from Figure 4.1, signification comprises abstract social structures, interpretive schemes and discursive practices.

**Figure 4.1**



(Adapted from Macintosh, 1994, p173)

“Signification structures [Box A, Figure 4.1] are organized webs of semantic codes” (Macintosh, 1994, p172, brackets added).

The “organised webs of semantic codes” in the context of this thesis refers to the links between definitions, accounting rules and the results of political policy decisions in the formulation of the social structures of accounting. Social actors draw upon the signification structure using interpretive schemes.

“Interpretive schemes [Box B, Figure 4.1] are the stocks of knowledge, skills and rules used by agents to draw on the signification structures in order to communicate with each other.” (Macintosh, 1994, pp172-3, brackets added)

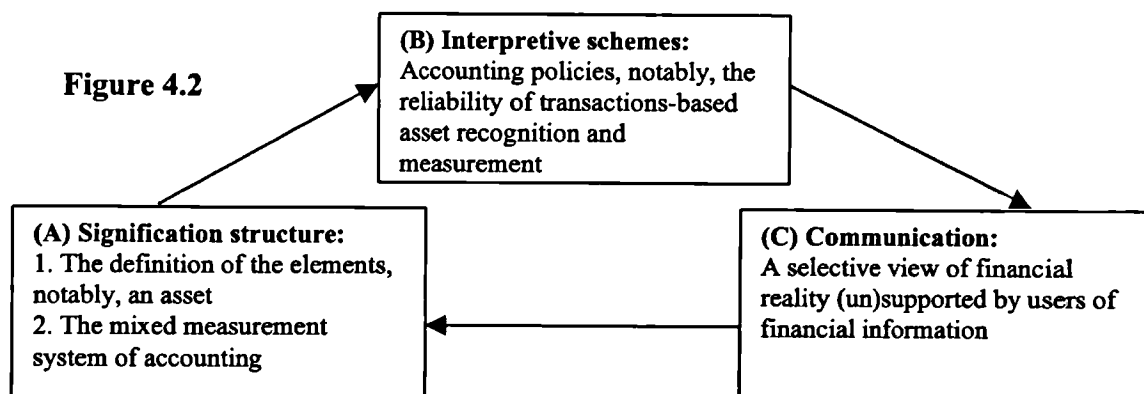
The “stocks of knowledge, skills and rules” in the context of this thesis refer to accounting policies that are used in order make sense of what social actors do. The most notable policy in respect of goodwill and intangible assets relates to the reliability of transactions

based measurement as recorded using double entry bookkeeping skills and as selectively structured and aggregated into “elements” (and sub-elements) for disclosure purposes. The aim of this interpretive act is to communicate financial information to would-be users of it:

“In day-to-day interactions human agents draw upon interpretive schemes in order to communicate [Box C, Figure 4.1] meaning and understanding [Box D, Figure 4.1]” (Macintosh, 1994, pp173, brackets added)

At the same time, the communication of meaning (Box C), typically, positively reinforces the social acceptance of the signification structure (Box A) as a worthwhile one to adopt, in this thesis, for the benefit of society in the domain of financial reporting. The recursive process of ‘social action reinforcing social structure’ is presented in Figure 4.1, above, that is, where social “structure [Box A, Figure 4.1] is both medium and outcome of the reproduction of practices [Box B, Figure 4.1]” - what Giddens (1979, p5) referred to as the “duality of structure”.

The three recursive elements of Figure 4.1, (A),(B),(C) are presented in more detail in Figure 4.2.



Box A, Figure 4.2 summarises the two principal features of the signification structure to be presented, in detail, later on in Figures 4.3a and 4.3b. One can see, for example, that a mixed measurement basis exists in the social structure of accounting (Box A): costs and

valuations, except that the use of valuations are subject to the interpretation that most of them are initially transactions-based (Box B). Thus, the communication of meaning (Box C) is a selective one being subject to that caveat, a caveat that is supported by another aspect of the social structure of accounting: the definition of an asset (Box A) and the requirement for “transactions or events” (ASB, 1995b, p53, 1999, p50). It follows that the ‘communication’ (Box C) of meaning can also be negatively reinforcing (as well as, more typically, positively reinforcing) of the signification structure (Box A), that is, where social actors regard the signification structure as being unnecessarily restrictive in the communication of meaning to would-be users of accounting information. The most notable example in this regard manifests itself in the exclusion of non-transactions-based, internally generated intangibles from the financial statements. Thus, there is an in-built tension within the signification structure which, as we shall see in section 4.3, the respondents to the FRS10 consultation process had some comments upon.

Reliability of measurement (Box B), whether transactions-based or valuations-based, is essentially a subjective assessment. At the moment, the related accounting interpretation is generally to preclude the use of independent valuations at the initial recognition stage of an asset. That said, there is nothing to stop the accounting profession from regulating valuations-based initial asset recognition into existence if it chose to do so in respect of intangible assets. As a result, we have here a political struggle in which social interaction (Box B) on the two features of the signification structure (Box A) should have taken centre-stage but, actually, this did not occur. Whilst the FRS10 respondents commented upon them (Box C), they were not the central focus of the FRS10 consultation process. These two features actually have more to do with the *Statement of Principles* (ASB, 1995b, 1999) rather than FRS10 (ASB, 1997). The important point to comprehend,



therefore, was that the signification structure was not going to change regardless of the outcome of the FRS10 consultation process. Hence, the starting point for the consultation process was the Board's offering of six possible accounting methods in the discussion paper (ASB, 1993) – a technical debate, not a conceptual debate about the definition of an asset or the mixed measurement basis of the UK financial reporting system. This is important because the switch from the previous goodwill write-off approaches under SSAP22 to goodwill capitalisation approaches under FRS10 can be made 'technically' without reference to the 'conceptual' switch from 'goodwill non-asset' to 'goodwill asset' status at least for disclosure purposes. In other words, the FRS10 consultation process was not intended to debate the signification structure in any depth because to do so would be to raise challenges to the conceptual foundations of accounting itself, notably in respect of the definition of an asset. The result would have been a never-ending debate on an already vexed and longstanding issue.

The sectional structure of this chapter follows sequentially the contents of Figure 4.1, commencing with the signification structure (in section 4.1) and ending with some summarised outcomes from the above recursive cycle (in section 4.4).

#### **4.1 The Signification Structure**

Figures 4.3(a) and 4.3(b) flowchart the building blocks of the signification structure (Box A, Figure 4.2 previously) in respect of purchased goodwill and intangible assets. They should be read from left to right and continue as if joined together (right hand side of Figure 4.3(a) linking to the left hand side of Figure 4.3(b)). These flowcharts were selectively constructed from the content of the *Statement of Principles* (ASB, 1995b, 1999) and, to a lesser extent, from FRS10 (ASB, 1997).



Figure 4.3a:  
The Signification Structure

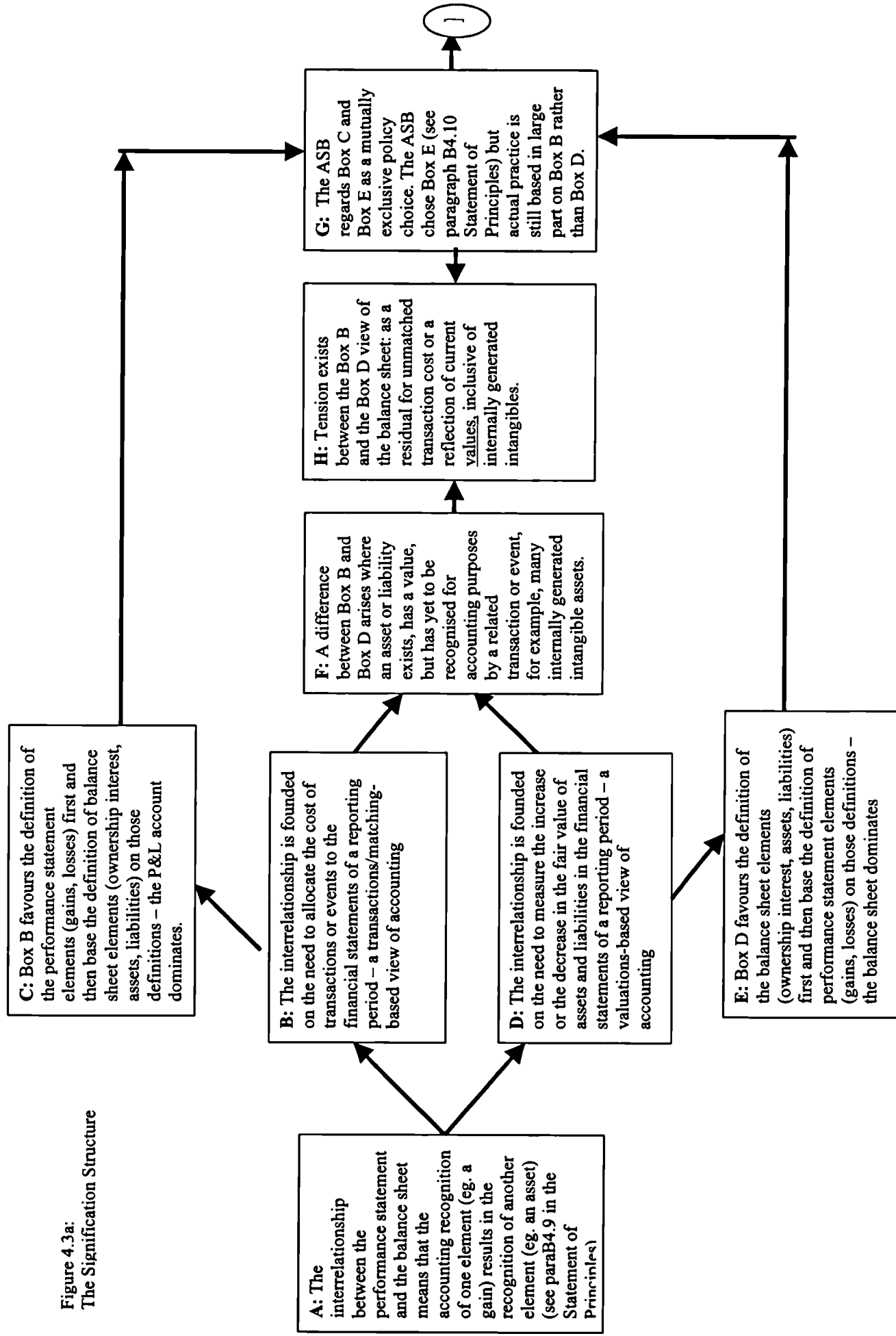
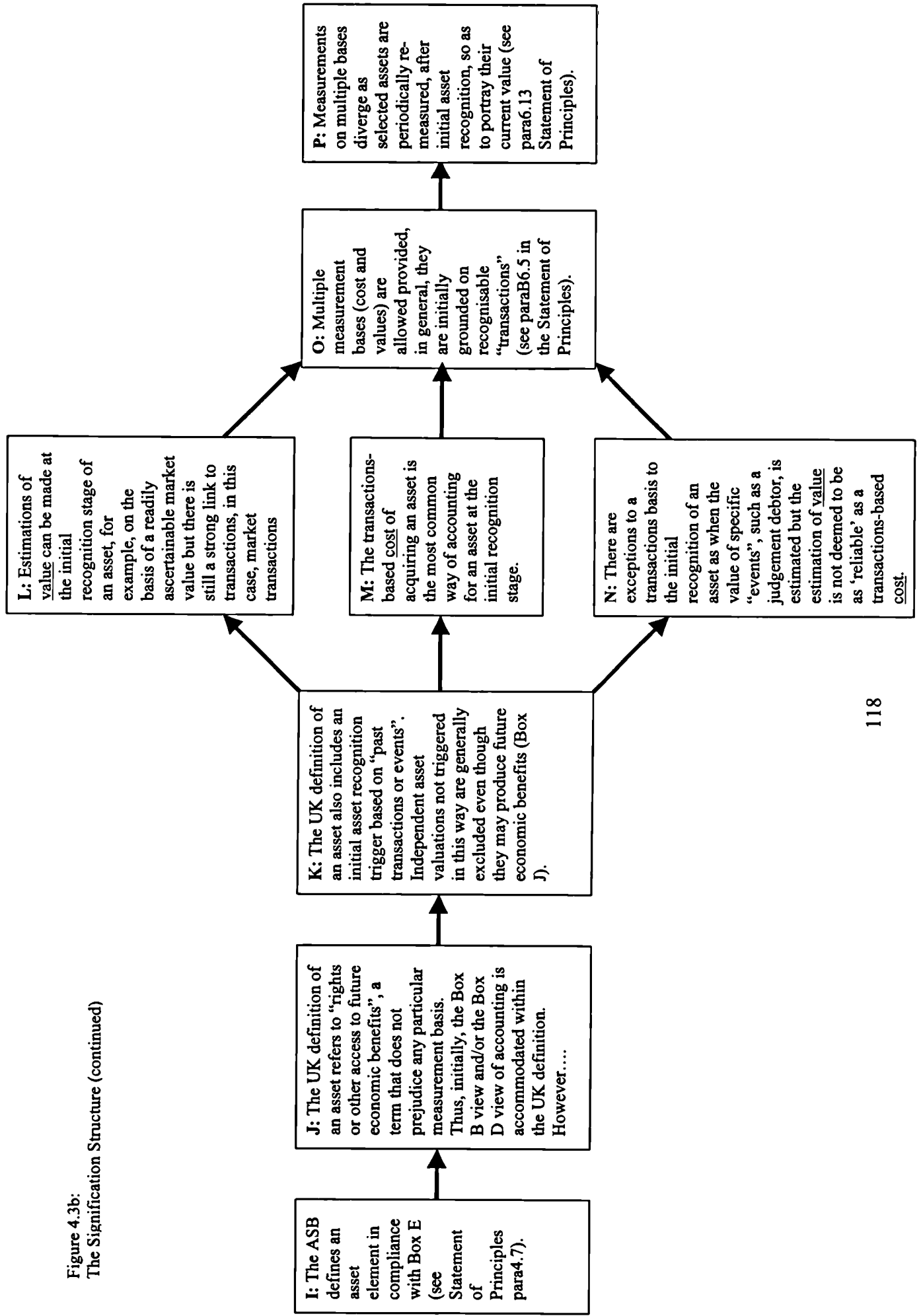


Figure 4.3b:  
The Signification Structure (continued)



#### **4.1.1 Explaining the signification structure in respect of intangible assets**

Each box in Figure 4.3 is labelled alphabetically and will be addressed in alphabetic order.

Each box builds upon the logic of the previous box. Repeated reference will be made to these boxes throughout the remainder of this chapter.

**Box A:** The structuring of transactions or events into elements (assets, expenses, liabilities, incomes and capital) manifests itself physically in terms of records of account. However, it is also a virtual structure because the use of financial metrics, as aggregated into elements, constitutes a metaphorical representation of the substance of transactions or events, each one, in reality, showing disparate characteristics according to business circumstance. Thus, for example, in the case of R&D cost, what may be represented as a transaction for an expense element, to others, may be represented as a asset element (see, for example, Lev and Sougiannis, 1996). Additionally, it is a flexible and robust structure in that one is able to mix the above elements together in a way that few other systems of metaphorical representation are able to achieve and still convey meaning thereby. For example, transactions can be consistently added and subtracted across elements unlike, for example, the four elements of Kaplan and Norton's (1992) balanced scorecard.

Each element (asset, expense, liability, income, capital) could be defined independently of each other but the Board argues that "such an approach risks leaving gaps or creating areas of overlap" (ASB, 1999, paragraph B4.9, see also, ASB, 1995b, p53). Certainly in practice, rather than by definition, the interrelationship of the balance sheet and performance statement elements is formalised and underpinned by the longstanding practice of double entry bookkeeping.

Let us briefly consider this interrelationship further because it can be argued that many of the problematic issues in financial accounting stem from the inability to delineate each element of this interrelationship. For example, in simplistic terms, the ‘WorldCom’ debacle in 2002 stemmed from an inability, wilful or otherwise, to delineate an asset from an expense such that substantial amounts of the latter were capitalised (balance sheet) rather than being written off (P&L account). In the context of this thesis take, for example, the issue of purchased goodwill which was written off, pre-FRS10, and capitalised, post-FRS10. It can be argued at one level of enquiry that the entire goodwill debate has been about how to write it off, gradually as an amortised/impaired asset or immediately as an expense against profits, above or below the line. No attempt has, or is, made to delineate a goodwill asset element from an expense element according to some recognition criteria based on the nature of an asset because none exist. Instead, the profession is reliant upon the robustness of a few core definitions, notably the definition of an asset.

**Boxes B and C:** The Board asserts the central role of transactions-based measurements in accounting in the following terms (ASB, 1999, paragraph B4.13, brackets added, see also, ASB, 1995b, p100-102):

“It is sometimes suggested that, by defining the performance statement elements [gains and losses] by reference to movements in assets and liabilities, the draft Statement will shift the focus of accounting away from transactions. The Board does not agree with this suggestion. Accounting is a process that is primarily concerned with allocating the effects of transactions to reporting periods, and the approach set out in the draft Statement will achieve exactly that.”

Transactions-based measurements clearly dominate at the level of daily accounting practice, that is, “allocating the effects of transactions”, above, through the application of the matching concept to periods of account (see Box B). At the level of accounting theory it therefore seems logical to assert the primacy of the performance statement and the

definition of its related elements, that is, gains and losses (see Box C). In other words, the process of allocating expenditures to the current period of account dominates to the extent that the balance sheet becomes the residue of those elements not allocated to date. As such, the balance sheet may well contain items of deferred 'revenue' expenditure whose 'assetness' is open to question. However, as one can observe from the above quotation, this is not the case. Instead, the Board clarifies its stance of defining the performance statements only in relation to movements in assets and liabilities in the following terms (ASB, 1999, paragraph B4.17):

“One other possible approach to defining elements might have been to retain the draft Statement’s definitions while at the same time giving the matching principle precedence over the definitions. However, as already mentioned, the absence of robust revenue and expense recognition criteria means that this approach would not result in a Statement of Principles that provides clear and unambiguous answers to the questions posed by the recognition process.”

In other words, primacy rests with the definition of assets and liabilities and by implication, the balance sheet (Box E and not Box C). The absence of robust revenue and expense recognition criteria is a worrying situation that tends to affirm the earlier assertion as to a delineation problem. That is, unless, correspondingly, the definitions of an asset and a liability are indeed 'robust' and, therefore, expenses and liabilities are respectively, the residual of what is not captured by these definitions. But this is still worrying because until one has, for example, defined both the asset and expense elements one cannot begin to say with some degree of clarity what will or will not count as a particular element for accounting purposes. Also, where is the related transaction to be disclosed in either the balance sheet or the performance statement? Thus, accountants enjoy a considerable degree of latitude as to what will or will not count as either an asset or an expense. An obvious omission in this regard is the absence of many internally generated intangible

assets from the balance sheet which may or may not have ended up as performance statement expenses depending on whether their recognition was transactions-based or not.

The linkage of Box B to Box C in Figure 4.3(a) is broken by the Board in the following terms (ASB, 1999, paragraph B4.14, brackets added):

“Although a number of definitions [of an expense] have been suggested over the years – for example, expenses could be ‘expenditure that has expired during the period’, ‘expenditure that relates to the reporting period’ or ‘charges against the current period’s revenue’ – those definitions seem to promise only circularity, vagueness and reliance on intent. The Board does not believe that these definitions provide a proper basis on which to develop a Statement of Principles.”

Given the central role of transactions-based measurement in accounting (see paragraph B4.13, ASB, 1999 and ASB, 1995b, pp70-71), it would have been possible and even logical to overcome the above criticisms of “circularity, vagueness and reliance on intent” through the provision of a better definition however that may be achieved. Instead, Box C is ultimately rejected (see Box G) on the basis of a ‘belief’ that it is not a proper basis. It is suggested that a belief is not the same thing as a reasoned basis for accepting or rejecting arguments about ‘circularity’, ‘vagueness’ or ‘intent’. The key issue here, however, is not whether Box C should be the dominant accounting viewpoint, rather, it is the fact that, having adopted Box B, it is suggested that the more logical stance would have been to also adopt Box C. In other words, accounting is seen as a transactions-based process (Box B) that records and aggregates those transactions for the current ‘year ended’ in the performance statement (Box C), any balances remaining after every item is matched being consigned to the balance sheet. It is not primarily focused on producing a complete economic view of reality (however that may be portrayed in the balance sheet) so much as maintaining accurate records of the transactions that have taken place in a reporting period.



In response, the Board intimates that breaking the link between Box B and Box C “seems counter-intuitive” but says that it is not (see ASB, 1999, paragraph B5.1). This is because the existing requirement for recognition on the basis of a transaction allocated to a reporting period is common to both an asset as well as an expense. Therefore, it is argued that the starting point in the recognition process should be one that decides, on the basis of the definition of an asset, whether a transaction is an asset or not. Then, to distinguish the effects of those transactions, in terms of whether they should be ultimately recorded in the balance sheet or the performance statement, by reference to the matching principle. The Board is careful to assert that the main driver of the recognition process is not the matching principle, rather it is the definition of an asset (see ASB, 1999, paragraphs 5.27 – 5.28, ASB, 1995b, p76). However, another important point to note here is that there is no convincing argument to reject the linkage of Box B and Box C, the above reasoning simply reasserts the primacy of the definition of an asset rather than the definition of an expense.

To illuminate this point about primacy, the Board considered the possibility of defining the elements in a way that combined asset recognition criteria with revenue recognition criteria particularly since, to repeat, they are both largely transactions based. However, the Board said (ASB, 1999, paragraph B5.2, brackets added):

“Although this suggestion seems attractive, in the absence of robust revenue-based recognition criteria it is not clear how it could be achieved in practice without significantly weakening the principles in the draft Statement [of Principles] relating to the identification and recognition of the elements.”

How such an approach would “weaken the principles” is not articulated at all. There is a degree of circularity here. Specifically, one asserts that there is no robust definition of an expense, then one chooses not to redress this absence, then one asserts that without a

robust definition it could weaken those aspects of the Statement of Principles relating to the identification and recognition of the elements. It is perhaps a self-fulfilling argument? Nevertheless, Box C is rejected by the Board on that basis (see Box G).

#### **Box D and Box E:**

In attempting to measure the increase or decrease in the value of assets and liabilities between two balance sheet dates, one is subscribing to an economic view of accounting, a view committed to measuring, as far as possible, the incremental wealth to the investor. In Box D this is referred to as a valuations-based view of accounting and it is entirely consistent with the priority given to an asset definition (Box E) founded on the requirement for future economic benefits. In contrast to a transactions/matching view of accounting (Box B), the valuations-based view (Box D) would attempt to include all price increases typically expressed in terms of the disclosure of current values. Also, it would include the value of assets currently falling outside the ambit of the “transactions or events”-based recognition criterion, such as internally generated assets (see Box F).

The linkage between Box D and Box E centres upon the term “fair value”, per FRS7 on *Fair Values in Acquisition Accounting* (ASB, 1994c). Specifically, that if the balance sheet should show the fair value of assets acquired then this is suggestive of a valuations-based view of accounting where the financial statements, wherever possible, should attempt to show current values.

Fair value is defined (p6) as:

“The amount at which an asset or liability could be exchanged in an arm’s length transaction between informed and willing parties, other than in a forced or liquidation sale.”

In most cases, the fair value will be at transactions-based cost, which, at the initial recognition stage, will also typically be an asset's current value. Thus, in most cases there will be little practical difference between Box B and Box D:

“That is because, in the case of a transaction, the fair value of the consideration paid or received (i.e. the transaction cost) is equal to *both* the fair value of the asset or liability acquired and the current value of the asset or liability at the time of acquisition” (ASB, 1999, paragraph 6.9).

There are exceptions to this typicality and an example is given above – a liquidation sale. Other differences, to repeat, include Box F in respect of internally generated intangible assets. The key point here is that the Board declares that the accounts should attempt to show a fair value (supportive of Box D), a value which is often, but not always reflective of transaction cost. So, for example, on this latter point, the Board states in respect of a business acquisition (ASB, 1994c, paragraph 43):

“Where similar assets are bought and sold on a readily accessible market, the market price will represent the fair value. Where quoted market prices are not available, market prices can often be estimated, either by independent valuations, or valuation techniques such as discounting estimated future cash flows to their present values.”

Thus, fair value can represent a multiplicity of measurement bases and the choice between them is often discretionary. For example, the Board states:

“It can generally be assumed that, in the absence of evidence to the contrary, a transaction has been carried out at fair value. In such circumstances, the transaction cost involved can be determined by reference to the fair value of either the asset (or liability) acquired or the consideration paid (or received); *whichever fair value is easiest to measure will usually be used*” (ASB, 1999, paragraph 6.10 - italic emphasis added).

Let us consider this statement. First, the term transaction cost (or “consideration paid”, above) and the fair value (or the value of “asset (or liability) acquired”, above) can be used interchangeably. In other words, one can ‘pick and mix’ between Box B and Box D.

Second, it does not appear to matter which measurement method dominates, cost or value, whichever “is easiest to measure will be used.” In practice, this will undoubtedly be the

transactions-based cost but the declared theoretical dominance of fair values, it is suggested, is reflective of a desire to always reflect current values in the balance sheet wherever this is practically possible.

The use of valuations independently from a transactions-based cost is not excluded at the initial recognition stage of an asset (see Box N). The Board, for example, says that “events other than transactions may nevertheless also result in the recognition and derecognition of items” and they list a number of examples (ASB, 1999, paragraph 5.3, see also ASB, 1995b, p72). They also state (ASB, 1999, paragraph 6.9, see also ASB, 1995b, p78) that: “A measure derived from a generally accepted valuation methodology and supported by a reasonable amount of confirmatory evidence will usually be a sufficiently reliable measure.”

And this key point informs the construction of the entire signification structure in Figure 4.3a&b: the requirement for ‘sufficient evidence’ for asset recognition and ‘sufficient reliability’ in asset measurement (see ASB, 1999, chapters 5 and 6 respectively and ASB, 1995b, chapters 4 and 5 respectively). There are guidelines to help where uncertainty exists (ASB, 1999, pp66-72, ASB, 1995b, pp76-79), though in essence the requirement for ‘sufficiency’ is a matter of judgement (confirmed ASB, 1999, paragraph 5.15 re sufficient evidence (see also, ASB, 1995b, p77) and paragraph 6.12 re sufficient reliability (see also, ASB, 1995b, p81)).

Though speculative, it would seem that if a valuations-based approach was deemed to be sufficiently reliable, then the profession would move to that basis for the sake of producing more relevant ‘current value’ information. But the move towards a full valuations-based approach is, at this stage, a step too far:

“It is worth noting that the framework in the draft Statement [of Principles] is unlikely to suggest that current values should be used for assets and liabilities other than certain types of investments, commodity stocks, financial instruments and some or all land and buildings” (ASB, 1999, paragraph 6.9, brackets added).

That said, it should also be noted that in the early draft of the Statement of Principles, (ASB, 1995b, p93):

“The Board therefore believes that practice should develop by evolving in the direction of greater use of current values to the extent that this is consistent with the constraints of reliability and cost”

#### **Box F**

Implicit to the acceptance of a pure transactions-based view of accounting is the understanding that the requirement for “transactions or events” sets a limit to attempts at portraying business reality. Thus, an internally generated intangible may exist, may be the mainstay of a business and yet never be recognised for accounting purposes. For example, as when the patent holder and sole owner of a business uses his invention to create future economic benefits for his business. Until the patent is transacted for, it remains unrecognisable for accounting purposes.

On the other hand, implicit to a valuations-based view of accounting is the current absence of any recognition criteria such that valuations may be performed on individual assets or bundles of assets as the valuer sees fit.

A criticism levelled at those who advance the case for the valuation and disclosure of internally generated intangible assets is that any capitalised valuation may include an element of double counting. That is to the effect that some or all of the expenditures have already been matched against previous years’ revenues. As such Box F would be incorrect in that a transaction or many transactions had already taken place in respect of the

internally generated intangible asset. It was simply that they had been expensed instead of being capitalised. In the absence of rigorous asset and expense recognition criteria and an ability to disaggregate expense headings historically, one cannot accurately respond to the criticism. However, what one can say is that such a view remains based on a transactions/matching view of accounting. A valuations-based view, on the other hand, does not need to be cognisant of past transactions or events. It simply asks whether an asset currently exists, whether it can be recognised as contributing to future economic benefits and then seeks to value it independently of any transactions.

**Boxes G and H:** The Board regards the primacy of Box C or Box E as a mutually exclusive policy choice:

“As the definitions are to be interrelated, it follows that either the balance sheet elements should be based on the definitions of the performance statement elements or vice versa...” (ASB, 1999, paragraph B4.10, see also ASB, 1995b, p53).

The Board chose Box E:

“...As explained more fully in paragraph B4.14, a robust definition of the performance statement elements has never been developed. On the other hand, robust definitions of assets and liabilities exist and have been incorporated in the conceptual documents developed by all the leading financial reporting standard-setters around the world. Therefore, this draft Statement [of Principles], like its predecessor, defines assets and liabilities, then bases the definitions of gains and losses on movement in assets and liabilities” (ASB, 1999, paragraph B4.10).

Balance sheet assets are to be valued at fair value (Box D). In the vast majority of cases the cost of daily transactions will reflect the item’s fair value. Thus, it would be possible to superimpose Box B onto Box D and eliminate Boxes B and C altogether were it not for the effect of price increases and the existence of those internally generated intangible assets currently falling outside the ambit of asset recognition based on “transactions or events”.

As a result, tension exists (see Box H) between a Box B view of the balance sheet, as a

residual of what is left over from the matching process in a period of account, and the alternative view (Box D) of a balance sheet. That is, one which attempts to portray the current value of all the assets of a business including the internally generated ones (Box F).

Let us examine this ‘tension’ further. Box B views the accounting process in the nature of individual ‘parts’ to be aggregated into the ‘whole’. That is, transactions into elements into financial statements. The ‘whole’ may be, in reality, bigger than the available ‘parts’ because some of the ‘parts’ are not seen or they are ignored – as with internally generated assets. Nevertheless, the ‘whole’ will always be the sum of its ‘parts’ even if that produces a smaller picture of reality in the financial statements.

Box D, on the other hand, starts from the basis that the ‘whole’ picture in the financial statements is only reflective of reality where all the ‘parts’ are seen and nothing is ignored. Where some of the ‘parts’ are difficult to identify separately, as with intangible assets, then they may be bundled together so that they may be identified as a group – as with goodwill. The ‘whole’ though, is seldom the sum of its ‘parts’. This is because the interaction of the ‘parts’ produces synergistic gains or market driven gains or apparently arbitrary gains and losses, which are difficult to attribute to the individual ‘parts’. So, the financial statements probably still produce an incomplete picture of reality. Nevertheless, those who support a valuations-based approach to accounting would argue that it produces a broader and therefore more relevant picture than at present.

In starting from a position of trying to value the ‘whole’ picture in the balance sheet, whilst at the same time maintaining a broad accounting approach which is initially based on the

cost of individual 'parts', tension between the two viewpoints is inevitable. In response, the Board acknowledges that the balance sheet has some limitations:

"However, because its limitations, and the limitations of accounting in general, are well understood, the balance sheet is able to provide users with useful information about, inter alia, the entity's financial position" (ASB, 1999, paragraph B4.11 footnote, see also ASB, 1995b, p106).

The 'whole' and 'parts' idea was considered by Will Baxter who referred to it in the context of purchased goodwill as "the accountant's self-inflicted headache" (ASB, 1995c, p16). He cites the example of a pair of china shepherd figures costing separately £100 each, which together are valued at £1000. The £800 difference between the two measurement bases, which Baxter chooses to characterise in terms of "assets versus cash flows" (p17) rather than costs versus valuations, is called goodwill. He suggests (p18) that "...a gap between the two answers is not unlikely, and does not prove the existence of some latent extra thing. The 'whole' and the 'parts' are here different economic units...In other words, usually a subsidiary's market value is not derived from a group of assets but from a stream of flows. If we split off some of the value to represent independent assets, then what is left is not one more such asset but the remainder of the stream. This certainly is valuable; but it is not a detachable thing like other assets. It is instead a fraction of the subsidiary; its value and life depend on the subsidiary's value and life. Whenever the accountant splits up a market unit into artificial bits ('allocation') he is asking for trouble."

The point to note from Baxter's explanation is that it is measurement-based, not recognition-based. The £800 difference is presented in terms that the whole (£1000) is greater than the disclosed parts (£100 x2). However, there is nothing to prevent the accountant from disclosing the asset as a pair with a fair value of £1000 if he/she chooses to do so. The decision to be made is whether one discloses the individual costs (£100x2) or the valuation (£1000) or, more importantly, whether one wishes to adopt a single measurement basis for the sake of consistency and comparability, or not. The mismatch of measurement bases (Boxes B and D) is a valid point in the context of a business acquisition but the comparison to the purchase of china figures, with respect to this



distinguished academic, is a poor example. Baxter rightly refers to the £800 as a consolidation difference but the use of china figures as an example implies that the 'difference' arises from synergistic gains, which is not necessarily the case. It could more pertinently be said to arise from a mismatch of measurement methods alone: transactions-based vis-à-vis valuations based.

Finally, before we move from Figure 4.3a to the extension of the signification structure in Figure 4.3b, let us briefly look at an example of where the 'tension' portrayed in Box G is actually contained in the nature of one specific asset(?), purchased goodwill. Purchased goodwill is defined (ASB, 1997, p9) as:

“The difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities.”

In other words, the tension brought about by a combined Box B and a Box D view of accounting is actually built into the defined nature of purchased goodwill (underlined above) which is, therefore, simply regarded as a “difference” between the two viewpoints. Another way of viewing the situation is that Box B and Box D offers a macro view on the measurement problem at the heart of accounting which is then reflected at the micro level in terms of goodwill accounting. More on that point later, but it does provide an early warning signal as to the nature of goodwill as the “difference” between two measurement basis. Let us now turn to Figure 4.3b. Again, an explanation is offered according to the alphabetic ordering of the boxes.

**Box I:** Having chosen that the performance statement elements should be defined in relation to the balance elements, the Board defines an asset in the following terms (ASB, 1999, paragraph 4.7, see also ASB, 1995b, p53):

**“Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.”**

Interestingly, we can return here to the concluding comment from Boxes G and H about the nature of goodwill as the “difference” between two measurement bases. The comparison to be drawn is that, like the definition of an asset, the use of fair values (which like “future economic benefits” comprehends the use of any measurement method) is nevertheless triggered by the transactions based cost of acquiring a business. In other words the transactions-based recognition trigger, typically at cost, dominates in both instances.

**Boxes J and K:** The above definition of an asset refers to “rights or other access to future economic benefits” (Box J), a broad term which, whilst it does not prejudice the use of any particular measurement base, is typically interpreted in terms of eventually resulting in net cash inflows to the entity (see ASB, 1999, paragraph 4.16 and ASB, 1995b, p38). Thus, initially, the Box B and/or the Box D view of accounting is accommodated within the definition. However, the UK definition of an asset also contains an asset recognition trigger for the initial recognition of an asset within accounting (Box K). Asset recognition is triggered by the requirement for a recognisable past transaction or event. Thus, it would preclude the capitalisation of asset valuations where these arise independently of a recognisable past transaction or event. This would be particularly pertinent to the exclusion of most internally generated intangible assets from the balance sheet even though they produce future economic benefits.

**Boxes L, M and N:** It follows that the transactions-based cost of acquiring an asset is the most common way of accounting for an asset at the initial recognition stage (Box M).

With regard to other intangible assets, excluding purchased goodwill, where they are purchased separately they should be capitalised at cost (see ASB, 1997, paragraph 9).

Likewise, ‘purchased’ goodwill is transactions-based but its cost or value is, respectively, dependent on the relative proportions of the acquisition cost and the fair value of the acquired assets. As such, unlike any other ‘asset’ it can have a positive (cost>fair value) and a negative (fair value>cost) dimension to it.

Estimations of value can be made at the initial recognition stage of an asset (Box L), for example, where an intangible asset is extracted and capitalised separately from purchased goodwill:

“It should initially be recorded at its fair value, subject to the constraint that, unless the asset has a readily ascertainable market value, the fair value should be limited to an amount that does not create or increase any negative goodwill arising on acquisition” (ASB, 1997, paragraph 10).

The interesting point here is that the fair value (Box D) of an intangible asset is limited to the total amount of purchased goodwill, that is, the residue from the transaction-based cost (Box B) to acquire a business. There is some latitude to value and capitalise intangible assets here but the overriding requirement, referred to earlier in paragraph 10 quote, is that an intangible asset should be measured reliably. And that reliability in the measured value of an intangible asset is, to some extent, guaranteed by reliability of the measured cost of purchased goodwill above, which it is not allowed to exceed. Thus, in the longitudinal survey presented in appendix A, all brand capitalising companies do so as an extraction from purchased goodwill.

Again, estimations of value can be made at the initial recognition stage of an asset (Box L), for example:

“An internally developed intangible asset may be capitalised only if it has a readily ascertainable market value” (ASB, 1997, paragraph 14).

It was a major development to the existing signification structure presented in Figure 4.3a&b when this provision was ‘enacted’ because, potentially, it eliminated some of the difference referred to in Box F and therefore neutralised some of the tension referred to in Box H. However, as was shown in chapter two, the requirement for a readily ascertainable market value, or RAMV, was subject to strict criteria so as to maintain sufficient reliability of measurement. In essence, it was still a transactions-based measurement, albeit, by reference to frequent and similar market based-transactions.

Finally, there are exceptions to a transactions-basis to the initial recognition of an asset (Box N), as when the value of a specific event is estimated. The Statement of Principles (ASB, 1999, paragraph 5.3 and ASB, 1995b, p56) identifies many of these events but, in general, their value tends to be recognised only where there is no reasonable alternative in terms of an available transaction-based cost. For example, ‘discovery’ and ‘extraction’ are considered to be “events” (ASB, 1999, paragraph 5.3a&b). However, whilst the transactions-based cost of discovery and extraction may be capitalised the value of the extracted mineral reserve is not. Thus, the term “events” may be applied widely in theory but, in practice, the availability of a related transaction dominates such that transactions-based cost substitutes for estimations of value wherever possible because it is deemed to be a more reliable measure.

**Boxes O and P:**

Boxes L, M and N provide a clear indication that multiple measurement bases are used in accounting (Box O). The common feature that binds them in most cases is transactions-based recognition either directly or indirectly by reference to the current market value. The inevitable consequence of what is called a mixed measurement system is that comparability between accounts is weakened where different measurement bases are used. However, even if at initial recognition all companies used the same measurement basis for all assets this would still not prevent divergence where assets are remeasured after initial recognition (Box P). The crucial factor at play here is that of time, that is, with the passage of time the measurement becomes unreliable for comparative purposes. Further, transactions-based measurements are tied to a point in time, even with a readily ascertainable market value or RAMV. In contrast, for example, the application of ‘value-in-use’ (future cash flows) mixes the time frames as well as adding to the mix of measurement methods. We return to the issue of time when considering legitimisation in chapter five.

To summarise so far:

The explanation of the signification structure presented Figure 4.3a&b is now complete, most of it being based on what can be observed from the *Statement of Principles* (ASB, 1999). Whilst its impact is obviously broader than just in respect of intangible assets, nevertheless, the tension within this structure is particularly acute with such assets. It is at the boundary between an asset and an expense that the problems arise. That is, where an item lacks the tangibility of most fixed assets, where it appears because of its intangible nature to have been consumed or expensed but, in fact, is able to contribute to the creation of future economic benefits. The boundary demarcation problem remains as something that can be interpreted differently by each accountant. In this regard, the term “future

economic benefits” from the definition of an asset does not help because it can be interpreted widely. More on that point later. Also, the term “past transactions or events” from the definition of an asset is a robust boundary but, as was shown in Figure 4.3a, there is an in-built tension at the initial recognition stage between transactions-based costs and fair values. This tension is not so much a problem with the operation of the signification structure itself, rather it has to do with whether that structure serves the interests of actors when internally generated intangible assets are excluded from it – a demarcation problem. This is because it is possible to fair value many intangible assets independently of the recognition boundary created by “past transactions or events” and this is the cause of most of the tension over the signification structure. As will be shown in section 4.3, these issues were also raised by many of the respondents to the Board’s papers on *Goodwill and Intangible Assets*. The interaction between the Board and the respondents did bring about change, such as the extension of the signification structure to include RAMVs for internally generated intangible assets. But, in general, the heart of the signification structure based upon the primacy of the definition of an asset and the use of a mixed measurement system triggered by past transactions or events, remained untouched.

We move next from box A (signification) to box B (interpretive schemes) in Figure 4.1.

## **4.2 The interpretive schemes**

The basic accounting policies are the ‘interpretative schemes’, that is, the procedures which mediate between the (virtual) structure and the (situated) social interaction. In this case, to repeat, between the transactions or events, as aggregated into elements, and the communication of meaning to others through financial statements. Specifically, the interpretative schemes using

“accounting policies define the process whereby aggregated transactions or other events [the virtual structure] are reflected in financial statements [an interface for social interaction between compilers and users of accounts]. For example, an accounting policy for a particular type of expenditure may specify whether an asset or a loss is to be recognised; the basis on which it is to be measured; and where in the profit and loss account or balance sheet it is to be presented” (ASB, 2001, p7, brackets added).

Interpretation in practice, per FRS18, is guided by accounting policies such as accruals, realisation and going concern, as constrained by the requirements for reliability of measurement, relevance for decision-making purposes and comparability between accounts. The key interpretative scheme in respect of intangible asset disclosure is, to repeat, the requirement for reliability of measurement as afforded by transactions-based measurements. It was the application of this interpretive scheme that, for example, saw the reversal of United Biscuits Plc’s capitalised brand valuations, the reversal of the capitalisation of Mirror Group Plc’s Scottish newspaper titles and a restatement back to cost of Ladbroke Plc’s betting licences in 1998, all immediately post FRS10 – to be addressed in a longitudinal survey at the end of chapter six.

Reliability of measurement became increasingly clear as the main interpretive scheme in respect of goodwill and intangible assets. The discussion paper (ASB, 1993) was notable in that it proposed the subsuming of intangible assets within purchased goodwill, a proposal that was met with heavy opposition from the respondents to the paper. The following working paper (ASB, 1995a) reversed this position. What was noticeable was the subsequent heavy emphasis on reliability of measurement as the principal precondition for the accounting recognition of intangible assets separately from purchased goodwill. There was no similar emphasis in the discussion paper because purchased goodwill, and anything subsumed within it, was established by reference to a transactions-based cost, which was apparently deemed to be a reliable measurement (see ASB, 1999, pp80-82 and

ASB, 1995b, p82). Whilst the ASB actually adopted a mixed measurement system for assets (see ASB, 1999, p77-79 and ASB, 1995b, pp84-91 for measurement bases), the principal binding feature of this system, as legitimised by the UK definition of an asset, is the requirement for transactions-based measurements. That is, directly through a transactions-based cost of acquisition or indirectly through a multiple transactions-based 'readily ascertainable market value' or RAMV at the initial recognition stage of an asset.

The accounting policies are dynamic and are themselves the outcome of individual acts of communication. Thus, the interpretative schemes depend and draw upon the signification structure and, at the same time, reproduce that structure. So, for example, the long held SSAP2 policies of "consistency" and "prudence" in accounting (ASC, 1971) are now respectively incorporated into a revised policy centred upon "comparability" and "reliability of measurement" (ASB, 2001, p51/52). It could be argued, for example, that such accounting policy changes are a response to the changing nature of the asset "element", particularly the sub-element of intangible assets. The revised interpretative scheme no longer regards the prudent write-off of intangible assets as meaningful. Instead, a policy is now advanced in FRS10 mandating capitalisation, subject to the overriding and explicitly stated requirement for reliability of measurement.

An alternative measurement basis to that presented in the existing signification structure is one based on asset valuations independently of transactions. Prima facie, they are rejected because, firstly, either the related transaction is non-existent or the transaction(s) cannot be easily identified, and, secondly, because they are deemed to be unreliable measurements. This is because there is no fixed reference point (item, date and amount) by which to judge a value as there is with a transaction or with a specific event. However, many would argue



that with the passage of time transaction-based costs become unreliable in terms of their portrayal of current economic reality. Thus, 'reliability' is essentially a subjective assessment. At the moment, the initial recognition process of an asset tends to preclude the use of independent valuations but there is nothing to stop the accounting profession from regulating them into existence if it chose to do so. Because the profession chooses not to do so we have here a political struggle in which social interaction takes centre-stage, notably between accounting standard setters and those affected by their pronouncements. In this thesis, this is evidenced by the contents of the submission documents leading up to the implementation of FRS10. Let us explore those submission documents next.

We move next from box B (interpretive schemes) to box C (communication) in Figure 4.1.

### **4.3 The communication of meaning**

Section 4.3 is split into two sections. The first section, section 4.3.1, will look at the respondents' views on the first part of the of the signification structure as presented in Figure 4.3a. The second section, section 4.3.2, will look at the respondents' views on the second part of the signification structure as presented in Figure 4.3b. Repeated reference will again be made to the Boxes in Figure 4.3a&b. It should be noted that no respondent pointed to the signification structure as an entity because this is of the author's construction. Rather, comments were made on aspects of it which, in common with Box C, Figure 4.2, were both supportive and unsupportive of that structure according to one's viewpoint and, in some cases, self-interest.

#### **4.3.1. The signification structure for intangible assets – Boxes A to H.**

Many respondents felt that any discussion about the reliability of transactions-based measurements should first be grounded on an understanding of the role of the balance sheet. At the heart of this ‘understanding’ was the ‘reliability versus relevance’ argument. It may be summarised as a choice between the reliability of measurement afforded by transactions-based cost (Box B) and relevant measurements, notably those based on independent valuations (Box D), which would be inclusive of assets currently falling outside the existing transactions-based asset recognition boundary (see Box F). There were mixed views on the issue of reliability of measurement afforded by valuations.

On these two approaches (Box B or Box D) Professor Myddleton (ASB, 1995y, p62) said

“I think there is a danger that the Board all through its activities is mixing up values and costs. Again, you do not have to agree with this, but I think that this is a recognised position that a number of commentators have had. I am an advocate of historical cost accounting. I am not an advocate of mucking around with current values all the time. I appreciate that inevitably that there is some mixture, but I think from the way in which the Board’s statement on valuation went earlier, it seems to me that there is a real muddle – maybe there are two schools of thought on the Board itself – and that is from where the difficulty is coming, because, as you well know, unless you agree on from where you are starting or the basic framework of what you are trying to do, you are probably not going to get agreement on what should actually go into the accounts.”

Allister Wilson (ASB, 1995z, p110, brackets added) also

“...feels these questions are vital when considering an issue such as accounting for goodwill. That is something which is quite fundamental not only to this project but also to a number of the ASB’s projects.” [Specifically,] “...is the balance sheet destined to become a statement of wealth and the income statement destined to become a statement in changes in wealth as we have seen with a statement of total recognised gains and losses, or will the balance sheet remain a statement of residual historical cost balances (ASB, 1995z, p110, brackets added).”

Grinyer (ASB, 1994a, p156, brackets added) is clear that whichever view of the balance sheet is taken the supporting measurement basis should be applied separately, not mixed together:

“...matching based balance sheets do not show the value of the assets owned by the business, merely, the previous investments outlays which have not yet been matched against expected benefits...One should, then never criticise matching based balance sheets for failing to show the worth of assets. They do not claim to do so!...[In contrast (p157)]...“valuation” based methods are entirely different in conception to “matching” based approaches. Essentially they identify profit as the change in the worth of the business between two points in time. Consequently they require procedures for the valuation of the business. Such procedures inevitably involve assumptions, because the value of businesses will differ depending on the prevailing circumstances...[He continues (p158)]...“only confusion can, however, result if one attempts to mix matching based allocation concepts with valuation based concepts of adequate disclosure of worth. Resulting figures of profit would then have no definable meaning. Unfortunately the mixing of matching and valuation based concepts seems to underlie most of the ASB discussion paper on “Goodwill and Intangible Assets”.”

For example, the FRS10 accounting option has two elements to it:

capitalisation/amortisation or capitalisation/impairment review, the former being reasonably consistent with the matching concept and current practice, the latter with the valuation concept. Consider, for example, that in any impairment review a DCF valuation approach is undertaken with the constraint that it shall not exceed the original outlay.

According to Grinyer (ASB, 1994a, p159) this approach: “completely ignores the allocation of the original investment outlay by reference to the pattern of benefit derived.”

In other words, it is not compatible with the matching concept and is a valuation-based method capped by the amount of the original outlay. He argues (p159) that:

“...not only does the ASB favour the use of an inconsistent valuation based approach in matching based accounts, it apparently goes further and proposes that such an approach should be mixed with the use of a matching based one in calculating a single profit and loss account figure of goodwill amortisation (i.e. depreciation). This really cannot be acceptable.”

Inchcape Plc state (ASB, 1994a, p187) that:

“...there is a potential conflict between the wish for reliable, consistent and comparable financial data to be included in accounts and the wish for accounts to take into account a wide variety of more subjective factors in order to attempt to provide a valuation of an organisation. Different users will also have differing perspectives and priorities as to the purpose of financial reporting...We believe that while every effort can and should be made to incorporate more meaningful values within accounts, the latter can never fully measure the “true worth” of a company...Accordingly we feel that the primary purpose of accounts

should be to accurately reflect the substance of transactions that have taken place and, in particular, the cash flows that have arisen as a consequence. The balance sheet should, in so far as possible, avoid subjective valuations that cannot be directly linked to cash flows, even though this could possibly reduce its utility for investors, analysts and certain other users of accounts.”

This last point raises some interesting comments in respect of the role of the balance sheet as a valuations-based statement. Consider the following comments for and against valuations in Figures 4.4 and 4.5, respectively.

Figure 4.4: For the role of balance sheet as a valuations based statement

“I believe that the lay user of accounts broadly expects the balance sheet to reflect some concept of what the business is worth. He expects the totals to represent values with a lay concept. The current treatment of both goodwill and intangibles is a major impediment to those user expectations. Unless we get a closer reflection of the layman’s concept of value into the balance sheet, I think, as David [Tweedie] has said many times, the British balance sheet will then be destined to be meaningless. It will just simply be adding apples to oranges and hoping that the total means something to somebody” Neil Chisman (ASB, 1995x, p18, brackets added).

“...a considerable amount of work has been done on the valuations of intangibles and these valuations are now at least as valid as, for example, property valuations which are incorporated in accounts. There is no doubt that many intangible assets can be separately identified and properly valued and it would be misleading for them to be included as part of goodwill, especially if this were to mean immediate write-off. A useful corollary of the separate capitalisation of intangibles is that it reduces the size of the residual goodwill” The 100 Group (ASB, 1994a, p177).

“...that the methodology for the valuation of acquired intangibles such as licences, publishing rights and brands is highly developed, although it may need some codification to provide quality assurance, for example, through the development of valuation guidelines. In general the methods are as robust as the methods of valuing other items such as properties, investments and pensions.” Coopers & Lybrand (ASB, 1994a, p109).

Let us consider one comment from Figure 4.4. The appeal of Neil Chisman to user expectations is a common strategy of those seeking to change the content of the balance sheet. Similarly, the reference to “values with a lay concept” and the “adding of apples to oranges”, is a common strategy of those seeking a change to the basis of measurement. In the first instance, the appeal is directed towards ‘relevancy’ as evidenced by the inclusion of internally generated intangibles on the balance sheet. In the second instance, the appeal one suspects is directed towards the use of a single measurement method, rather than the present multiple basis, based upon a layman’s view of value.

**Figure 4.5: Against the role of balance sheet as a valuations based statement**

According to Graham Swetman (ASB, 1995x, p37) the approach of the ASB's public hearings rely upon:

"...an ill-conceived reappraisal of the purpose of the balance sheet. At present the balance sheet really contains amounts that are all capable of reasonably precise measurement, give or take a little on the property side. It does not pretend to be a valuation of the business which can only be determined really by market forces. The difference between book and market values represents the goodwill associated with the business, whether it is purchased or internally generated. This will, therefore, include a whole variety of intangibles, including brands, technology, dealer networks, market positions and the management teams. If you are going to include very arbitrary valuations for some of these items why not include measures for them all?"

In respect of purchased goodwill, United Biscuits Plc (ASB, 1994a, p474) state that the "...views on which of the alternative treatments of goodwill, proposed in the discussion paper, is the most appropriate, hinge on the perception of the purposes of the balance sheet. We support the view that the balance sheet is a record of historic cost rather than a statement of value. In line with this philosophy, it is appropriate that the full cost of an acquisition should initially be represented on the balance sheet and, as in the case of all assets with a long term benefit, this cost should be amortised so as to match the use of this asset with the benefit derived from it. We therefore support the "capitalisation and predetermined life amortisation" basis of accounting. We quite understand that it is possible to view the balance sheet as a statement of value and to construct a (probably complex) accounting philosophy to reflect this. Logically, this approach would require that the value of goodwill should reflect any subsequent enhancement. Similarly, the value of internally generated brands should also be capitalised. Merely to hold the goodwill on the balance sheet unamortised, or even subject to periodic review and write down in the event of permanent diminution (if this is truly measurable), does not sit comfortably with either philosophy and is not, in our view, supportable."

James (ASB, 1994a, p247) explains that

"The accounting profession quite inappropriately has attempted to increase the sophistication of the accounts in certain aspects in an attempt to represent certain economic realities while ignoring others. We should be absolutely clear that accounting standards should relate to accounts which are based on cost not value and that economic factors which are necessary for understanding the activities and operations of an enterprise should be the subject of separate statements within a Corporate report. For example, a set of accounts may set out the costs of drilling for oil in the North Sea while a separate statement based on a universally accepted methodology will indicate the anticipated reserves. As a profession our sophistication now substantially outweighs our competence."

Let us consider one comment from Figure 4.5. James (ASB, 1994a) provides a sharp contrast between the Boxes B and C view of accounting and the Boxes D and E view of accounting. Exploration cost is transaction-based (Box B) but in itself provides no future economic benefits. Yet, exploration cost may be capitalised where mineral reserves are proven. On the other hand, the mineral reserves are not transaction based, yet, they do provide future economic benefits once they are extracted. The mineral reserves can be

valued (Box D) but they are not capitalised. This is a good example of the tension referred to in Box H. Specifically, that where it comes down to a choice between capitalising the transactions-based cost of exploration (an expense) or capitalising the value of the mineral reserves (an asset) resulting from that exploration, the profession chooses to capitalise at cost because of the reliability afforded by such measurements. Yet, it is obvious that the true source of future economic benefits must be the mineral reserves. Thus, primacy may be given to the definition of an asset (Box E) in theory, but in practice the “future economic benefits” related to the mineral reserves are replaced by the revenue cost of exploration on the balance sheet. It would appear that Mr James would accept this prevailing situation because it is “based on cost not value” but likewise he presumably would also have to accept that ‘relevance’ was being sacrificed for the ‘reliability’ of measurement afforded by transactions-based cost.

Let us turn to one exchange of views that highlights the above measurement problem rather succinctly. At the public hearings, Mr Cook (ASB, 1995x, p10) asked Mr Caldwell a very searching, yet simple, question:

“Could you tell us whether there is any difference in the way in which you would set about valuing the future cash flows of a company and valuing the future cash flows of the intangible assets?”

The reply may be summarised as “there are different valuation techniques for the valuation of different assets”, which is not very satisfactory because such variation does not necessarily assist in the search for ‘sufficient reliability’ in the measurement of worth. One suspects that Mr Cook was intimating that there is no difference and that, therefore, the identification of income streams attributable to intangibles for valuation purposes is confused with income streams as a whole. Also, that the separation of the two is problematic.

David Tweedie (ASB, 1995x, p13) pursued Mr Caldwell on the idea of capitalising internally generated intangibles independently of a known transaction-based cost. He stated,

“...at least if you purchase something, whether it is goodwill or brands, there is a ceiling: you have written a cheque or you have issued shares that you can value and so on. How confident do you feel that the values that you are getting are actually realistic? Have there been any sales of these intangibles that you can verify or is there any evidence that we can see to show that these things are useful?”

To the apparent dissatisfaction of the Chairman, the response of Mr Caldwell was to advance the merits of valuations without necessarily being able to refer to an established market as a benchmark, as with, for example, the RICS indices on movements in property values. Nevertheless, Mr Caldwell stated

“...that there is a market for intellectual property. A more common way of going forward is by licensing...There is an awful lot more information about licensing of intellectual property.”

It would appear that David Tweedie remained unconvinced because he then addressed the valuation methods themselves, in particular, the use of net present values citing David Damant's objections to the use of future profits for valuation purposes.

The exchange between David Tweedie and Mr Caldwell was interesting because David Tweedie, it is suggested, sought to undermine the current approaches to valuations as unreliable, which is not a particularly hard thing to do. However, Mr Caldwell (p14) touched upon a pertinent point when he stated

“...it is rather like the chicken and the egg if there is no standard accounting policy upon the treatment of intangible assets or no perceived one, and that to some extent is why we are here today. I think that once the guidelines are laid down on the valuation of intangible assets, then one can build up this bank of information. It is relatively patchy at the moment because not everyone goes through that process. What I would say is that it is being refined.”

The comment was interesting because Mr Caldwell effectively placed the onus on the Board to rise to the challenge of reducing the subjectivity of valuations by regulating an approach to them that would gain acceptability by the subsequent widespread adoption of that technique. Hence the chicken and egg argument in that regulation establishes conformity, which establishes consistency, which is self-reinforcing because everyone relies upon it for financial information purposes, but first, there must be reliability of measurement. The point here was that the ASB was apparently not prepared to address that particular challenge preferring instead to rely on the existing recognition boundary of a known transaction-based cost or a transaction-based RAMV.

#### *A connective comment*

An important point to note here between the valuations and transactions/matching approaches is “that (a) they are different, (b) they are mutually exclusive, and (c) “matching” is the basis mainly used in practice” (Grinyer, ASB, 1995c, p126) – see Box G in Figure 4.3a. The capitalisation, retention and review of goodwill for impairment would reasonably be categorised as a valuation approach whereas to capitalise and amortise goodwill would be categorised as a matching approach. If, as Grinyer asserts, they are mutually exclusive approaches then a hybrid of the two accounting methods would appear to be a ‘non-starter’. Yet, this is what has occurred in FRS10. It does not negate the signification structure, it simply highlights the tension within it, as Box G suggests.

The tension in the existing signification structure between the ‘cost versus value’ (Boxes B and D) view of accounting is evident from the above quotations. Transactions-based measurements limit the information content of the balance sheet which is, nevertheless,



still deemed by the Board as being able to convey “useful information.” We can see from Figure 4.4 that there are those who disagree with the Board’s stance on this matter preferring, instead, to move towards a more market based balance sheet which attempts to show movements in real capital rather than book capital. Equally, there were many expression of unease about moving away from a traditional transactions-based view of accounting (Figure 4.5). There was also an understanding about the inevitably loss of ‘relevance’ in the information content of published financial statements should transactions-based cost be the sole basis for measurement purposes, in particular, through the non-disclosure of internally generated intangible assets (Box F). Let us look at that point next.

It is important to now turn to the tension between a ‘cost versus value’ by reference to Box F, specifically, the inconsistency of capitalising the cost purchased intangible assets and not capitalising the value of internally generated ones. At the public hearings, Mr Chisman (ASB, 1995x, p19) pointed to this inconsistency by reference to the following “facile” example of an intangible asset, that was, initially, outside it and then subsequently captured within it after being sold. He said:

“A business that has been built up by advertising starting from scratch, such that it has very few tangible assets (let us say none), but it makes a profit of £1 million a year, largely from the intangible assets of a customer list and reputation. If this business is then sold for £10 million, consider the balance sheet before and after the sale. Before the sale, there are no assets in the balance sheet, after the sale there is goodwill of £10 million in the balance sheet of the acquiring company, but, of course, the business has not changed. Clearly, before the sale there was an intangible with a value of £10 million and we should work to allow that intangible to be recognised in order to bring meaning to the balance sheet.”

Mr Chisman argued that he did not think that it was reasonable that the accounting standard, referring to FRS10, should allow the same economic entity to be validly accounted for with two completely different balance sheets.

The approach to goodwill rests fundamentally on whether there is a transactions/matching only view of accounting (Box B), favouring historic cost, or a valuation view of accounting (Box D), favouring the measurement of internally generated as well as purchased intangibles. Alternatively, there is the current hybrid approach of the above two viewpoints where initial recognition is based upon fair value which, in most cases, tends to be transaction-based cost. Subsequently, however, selective remeasurements are allowed using any valuation basis. David Tweedie (ASB, 1995z, p123, brackets added), in response to Allister Wilson, said:

“...you are quite right when you said that it depends where you come from. As Ken [Wild – Board member] was saying, we are not terribly interested in internally generated goodwill, just purchased goodwill. We are seeing it as a consolidation difference and going back to the value of the subsidiary. If you look at it in that light and given there are only three things to do – I am thinking of a case in the late 80’s which I will not mention, but there is a company that bought its subsidiary for £500 million, say £300 million goodwill, writes it off to reserves in the UK accounts [pre FRS10]. Four years later it sells that subsidiary for £220 million and in the absence of UITF3 made a profit of £20 million, when in fact it made a loss of £280 million. Now, no signal was there in the British accounts that something was going on with investment...This led us, in effect, to the fact that you could actually give a signal to an analyst that something was going wrong and that is what led us into the impairment test...Now what I am concerned about actually is not so much stewardship as information and signals.”

It is interesting to contrast the two previous quoted paragraphs. In David Tweedie’s example, he is prepared to argue for the capitalisation of purchased goodwill on the basis that it provides “information and signals” to investors about a significant investment. But as Neil Chisman points out in his example, there may already be a significant internally generated investment for which, in contrast, there is no information or signal. This is because within a signification structure where transactions-based measurements dominate in practice, it has already been expensed or it is unidentifiable or it is the product of intellectual creativity unrelated to any transaction. Thus, it is possible to countenance

changes in accounting practice, for example, from 'reserve write-off' to 'capitalise and amortise', providing such practice remains within the signification structure. In contrast, there is no attempt to value Mr Chisman's assets in his example, above, until they are actually subject to a business acquisition – a transaction.

The accounting method of 'capitalisation and systematic amortisation' is criticised in the discussion paper because "purchased goodwill is recognised as an asset, whereas self-generated goodwill is not" and "some view this as a serious deficiency of this method" (ASB, 1993, p22). Specifically, that purchased goodwill may be amortised whereas internally generated goodwill is not. However, Grinyer (ASB, 1994a, p160) says that:

"...such an argument is surely totally irrelevant so far as matching based accounting is concerned. It is balance sheet orientated, emphasising the need for consistent figures of valuation in that statement. The important fact is that self-generated goodwill has (a) resulted from past outlays which (b) have been charged as revenue expenses in past profit and loss accounts. Strict consistency of treatment under a matching based approach might arguably be achieved only by immediately writing off acquired goodwill through the profit and loss account. Such a procedure is not likely to appeal to many practitioners on the grounds that it would grossly distort the accounting profit of a single period. The argument that we have not been able to recognise, and thus capitalise and amortise, the cost of self-generated goodwill surely should not be used to prevent us amortising as a cost the calculatable outlays for acquired goodwill."

Grinyer appears to be saying that self-generated goodwill and purchased goodwill are both transaction-based with the only difference being that the former is expensed immediately whereas the latter is expensed systematically over its amortisation period. However, what is apparently overlooked is that purchased goodwill is accounted for as an asset and self-generated goodwill as an expense, and that this is inconsistent even within a dominant transactions-based viewpoint if there is no difference in nature between the two types of goodwill. Indeed, as he indicates, strict consistency of treatment under a matching based approach is arguably achieved only by immediately writing off goodwill through the profit and loss account where both self-generated and acquired goodwill are regarded as an

expense. Conversely, where both self-generated and acquired goodwill are regarded as an asset then they should both logically be capitalised and then amortised, if a transactions based view is dominant (Box B), or reviewed/impaired, if a valuations view is dominant (Box D).

In contrast, in respect of intangible software assets, Paul Heaven (ASB, 1995y, p16)

referred to the difference between purchased and internally generated software as

“...no more than a make-in or buy-out type decision...Furthermore, it to me makes no sense, because the value shown in the balance sheet clearly does not represent the total value of the intellectual property rights of the software products that we as a group own. Indeed, it therefore follows that the amortisation charge does not reflect the total cost of depreciation, if you like, of the assets we own. I repeat that it makes the accounts difficult to interpret and, I would argue, even misleading.”

Mr Heaven rejected the ASB's accounting choices in the discussion/working papers in

favour of what he referred to as a “big bang charge to the P&L account”. The

consequences for the bottom line are obvious but, nevertheless, entirely consistent with a view that some, or all, of the premium paid to acquire a business is not an asset by nature.

Andrew Caldwell (ASB, 1995x, p8)

“...put forward the case that there are strong arguments for valuing what might be described as internally-generated intellectual property rights...I see no fundamental reason, as a layman, why the future income streams applicable to that intellectual property cannot be capitalised in a similar way to those which have been acquired. In that regard, I think that we would go beyond the Board's proposal that there should just be a ready market in respect of such intangibles...We would go on to propose that internally generated intellectual property or intangible assets, which fulfil the criteria that have been suggested for intellectual property on acquisition, should also be valued.”

Those criteria, however, are difficult to discern from Mr Caldwell's response but they appear to be the attachment of legal rights, an identifiable life and the existence of an

income stream from the intangible asset (p7). In contrast, the Board does not offer any asset recognition criteria at all other than those contained within the definition of an asset.

*To summarise so far*

Consistency between the disclosure of purchased goodwill/intangible assets and any internally generated ones is a relative concept. It is certainly inconsistent in terms of balance sheet disclosure but only if one regards both purchased intangibles and internally generated intangibles as assets. That is the assumption implicit to the portrayal of Box F in Figure 4.3a. However, if internally generated goodwill and intangible assets are expensed and regarded as such, then there is no inconsistency. Generally, there tends not to be even an available RAMV by which to alternatively recognise and disclose internally generated intangibles on the balance sheet. So within the existing signification structure it can be argued that there is consistency in the accounting treatment. The dilemma arises, however, where the existing accounting signification structure fails to capture within it many, clearly recognisable intangible assets that, nevertheless, do not make it on to the balance sheet. In particular, it raises doubts about the ability of the definition of an asset to distinguish between assets and expenses for those intangible ‘assets’ located at the boundary between the two types of debits. Also, doubts about the Board’s earlier assertion as to the user usefulness of the balance sheet particularly amongst those users who would argue for greater disclosure of internally generated intangible assets. We look at that next in the second part of the signification structure, Figure 4.3b, and the responses to it.

**4.3.2. The signification structure for intangible assets – Boxes I to P.**

The two approaches to measurement espoused in section 4.3.1 are captured within an asset definition based on the requirement for “future economic benefits” (the definitional

requirement shown in Box J), however, not every valuation is necessarily the result of “past transactions” (see Box K). It would appear, therefore, that the tension referred to in Box H actually appears to be built into the definition of an asset in Boxes J and K. In other words, there is a link between Boxes B, D and Boxes K, J respectively. In a way this is consistent, that is, the definition of an asset supporting the two views of accounting presented in Boxes B and D. However, it is also inconsistent if one takes the view firstly, that there should be one measurement basis only and secondly, that the asset definition should define first, the nature of what is to be recognised and then measured, rather than at present, asset measurement substituting for asset recognition.

Consider the following example in respect of recognising a purchased goodwill ‘asset’.

The measured transactions-based cost of purchased goodwill (Box K) dominates to exclude the substance of what is being measured, a substance which is simply assumed to produce future economic benefits (Box J). Of course, real wealth has been exchanged for this goodwill ‘asset’ so the assumption is that it must produce future economic benefits.

Mr Wild, for example, (ASB, 1995z, p122) said in respect of purchased goodwill:

“...We are trying to achieve information, genuine information in terms of has the value gone from when you bought – not hair shirt stuff, you know, has the particular business gone, but has the whole value gone. What is the harm in trying to give useful information?”

In response, Mr Wilson said:

“The answer is that you are deluding the user into thinking that goodwill has not been lost or is not dissipated. The answer is it has.”

In other words, the asset, if it was one in the first place, has been expensed. Neither assertion is provable until one first recognises the substance of what is being measured.

Nevertheless, Mr Wild’s reply was interesting because it highlighted the thought processes

behind the distinction between goodwill as an asset and goodwill as an investment, the distinction being somewhat tenuous at times. He retorted,

“I did not ask you about goodwill, I asked you about the value inherent in what you are purchasing [which, of course, includes goodwill!]. What is the problem in giving information about the investment that has been made and its usefulness to the company, where is the harm in that?” (brackets added)

To use David Tweedie’s example in section 4.3.1, capitalise the £300 million goodwill because the company has ‘invested’ in it, real money has been paid for it and it is a significant ‘investment’ worth signalling to investors. Such reasoning, it is suggested, attempts to detach itself from the simple logic of whether one is dealing with an asset or an expense. Logically, an investment is an asset and therefore capitalisation is wholly consistent with that viewpoint. Mr Wilson’s argument is that the asset or the investment, whichever terminology is preferred, has been lost or dissipated. It has effectively been expensed because a goodwill debit can only be either an asset or an expense and it is not regarded as an asset. It follows, if correct, that capitalisation is wholly inappropriate under these circumstances. It also follows, if correct, that impairment is wholly inappropriate because, if it is an expense, there is nothing to impair. One may have paid a lot of money for it but to capitalise it under such circumstances is akin to capitalising the Emperor’s new clothes. That was the point being made and it was a fundamental conceptual point to make about the ‘assetness’ of purchased goodwill, also, the ability of the definition of an asset to assist in that regard (Boxes J and K).

### *Summarising so far*

Purchased goodwill is the difference arising from the application of a mixed measurement: between purchased cost and the fair value of the acquired assets. The difference is typically referred to in terms of an investment because money has been exchanged for it. It

is transactions-based and is, therefore, recognised within the existing signification structure. However, its existence is dependent, like no other asset or investment, on the relative proportions of 'cost' and 'value' such that, occasionally, one can even be addressing the conceptually flawed concept of a negative asset or negative investment where the 'value' exceeds the 'cost'. And the definition of an asset does not help in this regard because the term "future economic benefits" does not prejudice any particular measurement basis so long as, in general, there is a recognisable transaction.

To continue, Box M presents the obvious: that transactions-based cost is the principle means of initially recognising an asset. However, it is suggested that the adopted Box E view of accounting places an obligation on the Board to move towards the use of current fair values wherever possible. The Board knows from previous experience with SSAP16 that a move towards a single current value approach is highly problematic. Nevertheless, the desire to reflect current values for the sake of 'relevancy' appears only to be tempered by the requirement for sufficient 'reliability' of measurement afforded by transactions.

Yet, the issue of sufficiency is essentially a judgement-call. Consider, for example, the view of the British Bankers Association (ASB, 1994a, p63):

"...we would accept that the valuation of intangible assets is not entirely straightforward. The methods currently employed, however, are no more difficult or subjective in their application than the ceiling tests which the ASB is now putting forward as one of the possible methods of accounting for goodwill."

The above "desire" is evident in the inclusion of RAMVs (ASB, 1997, paragraph 14) (see Box L) as an extension to the transactions-based cost approach (Box M). It is one which permits the inclusion of a select number of internally generated intangible assets previously outside the signification structure – see Box F. The above "desire" is also evident in the recent expansion of the term "events" (ASB, 1999, p64 and ASB, 1995b,



p56) to include many items not previously regarded as potential assets, such as exploration and discovery (Box N). We know that in practice transactions-based cost dominates, for example, in respect of the earlier comments on exploration cost and software development cost, respectively. Nevertheless, it is still reflective of a desire for greater relevance in what may be recognised for capitalisation purposes. Finally, the above “desire” is reflected in the formal use of discounted cash flows in accounting (ASB, 2001). This is undertaken only in the context of impairment reviews but it, nevertheless, sets a formal precedent that valuation-based approaches are gaining some acceptance from a regulatory viewpoint.

The layman’s view of the ‘current value’ of an asset is often expressed by accountants in terms of the net present value of future cash flows arising from the asset. However, the subjectivity of such an approach is well documented. Professor Whittington (ASB, 1995x, p25) had an interesting comment to make about how the Board had its knuckles rapped by the constituency when it attempted to include forecasting, presumably inclusive of the present value of cash flows, in the operating and financial review statement of published annual accounts. He said,

“I will read to you a telling sentence from another submission to us by somebody who is going to appear this afternoon. It says, “those who are familiar with the use of present values in the preparation of capital expenditure proposals will attest to the ease with which these calculations can be made to support a case.” I must say, although I understand the theoretical attractions of forecasting, that does ring rather true. Do you not think that there is a basis for financial reporting? If forecasting is still some way away and, therefore, even the application of ceiling tests to goodwill that has a measurable transaction behind it is quite adventurous, are we not going far enough at the moment?”

In response, Mr Chisman argued that in fudging cash flows the directors would be storing up future problems

“...because there is going to come a time when you can no longer forecast those cash flows going into the future and something is going to plummet. Concepts of prudence and auditability and so on will start to take over.”

However, the more interesting comment, above, is that Professor Whittington implies that the Board is going far enough at the moment. Indeed, the subsequent Financial Reporting Standard No.11 on the *Impairment of Fixed Assets* (ASB, 1998) was adventurous in that it included discounted cash flow techniques (DCF) in a substantive and formalised manner for what is probably the first time in current financial regulations. It represents the inclusion of one more measurement basis in an accounting system already based upon the use of multiple measurement bases (see Box O). In the case of DCF approaches, however, Professor Whittington's assertion that the ceiling tests applicable to goodwill have a measurable transaction behind them is perhaps stretching the linkage of DCF values to transactions-based costs too far: DCF being future based whereas transactions-based cost is usually historical. This is perhaps another example of the aforementioned "desire" to embrace current values but it also highlights the tension in the signification structure because of the apparent reluctance to move away from transactions as the basis for asset recognition. Contrast this situation with the case of RAMV's, the allowable alternative to transactions-based cost (Box L). The attachment of a RAMV to a measurable transaction is evidenced by frequent transactions in an established market. Not so with DCF approaches, which present high levels of estimation based upon "up-to-date budgets and plans" rather than evidence of frequent transactions (ASB, 1998, p23).

The issue of recognising the nature of an item before it is measured is obviously difficult when the item concerned has an intangible nature. It is not even attempted within the existing signification structure presented in Figure 4.3a&b - one is reminded of the weaknesses of the definition of an asset in that regard. Part of the reason is the issue of 'separability', which is outside the signification structure and therefore only briefly touched upon next.

David Tweedie (ASB, 1995y, p79), in respect of intangibles assets, argued that

“...one of the problems with which we are faced is how do we separate between something that is fairly similar to goodwill but is not quite goodwill? What is the difference?”

He asked Mark Armour/Alex Minford of Reed Elsevier (UK) Ltd,

“...you have 500 million of intangible assets, some goodwill and some publishing titles, how do you split them?”

The implication here is that other intangible assets are similar to goodwill. However, purchased goodwill is operationally defined as a “difference”, per SSAP22/FRS10. Being pedantic, one could easily argue that he is actually asking what is the difference between a ‘difference’ and other intangible assets. The questioning of Mr Armour was measurement focused without recognition of the substance (assuming there is any?) of what has been disclosed. Likewise, the reply was measurement focused:

“A methodology that is consistently applied can be monitored. We then look to see whether there are any changes that might suggest that we have actually been getting it wrong. So far we have found that the method that we have applied has been a consistent basis for attributing value.”

David Tweedie sought to establish some empirical support for this last assertion so he asked if, when Reed Elsevier sold some of its titles, whether they had any gains or losses on the sales compared to book value? Mark Armour (ASB, 1995y, p79) provided an interesting though inherently limited insight into the reliability of valuations. He said

“...we have had a number of gains and we have had some losses, once the goodwill is brought back under UITF3. It is not significant amounts, I am happy to say, but certainly we are able to attribute the relevant intangible asset value to the title being disposed of with quite some ease.”

A major issue for the ASB concerns the use of valuations. It is that a similar intangible asset in three different companies could be measured in three different ways. Thus,

reliability of measurement is not assured and comparability suffers as a consequence. It is a point that Weston Anson acknowledged was correct (see ASB, 1995x, p54). In response, David Tweedie said

“...that is a major problem for us then, because one of the things that we have said in the *Statement of Principles* is that, even though we recognise that a brand is an asset, we should not recognise it in the accounts unless it can be measured reliably. The broad definition that we make for that is to say that three or four people will get roughly the same sort of answer. You [responding to Weston Anson] have just scared me by saying that you will get three different answers.” (brackets added)

In reply Weston Anson said:

“No, I said three different methods could be used. You might not get three different answers. We might choose to use the replacement method, another client might choose to use the market-based/ royalty rate method and another one might choose to use excess cash flow. Theoretically, if we all work accurately, you should get the same answer...”

A similar exchange occurred between Mr Cook and Andrew Caldwell of Corporate Valuations (see ASB, 1995x, p10). Some interesting observations flow from this exchange. Firstly, brands are assets if only because David Tweedie clearly implies that this is so, above: “...we recognise that a brand is an asset...”. However, such a comment should be set against David Tweedie’s role as custodian of the Board’s signification structure. Secondly, brand valuations are apparently too subjective for inclusion on the balance sheet. However, reliability of measurement is a subjective concept depending, in part, upon who is doing it. Thus, even building values may be subject to wild fluctuations as with the Queens Moat Properties Plc hotel valuation debacle in 1992. The real challenge is whether it is possible to reduce the level of subjectivity to an acceptable level by regulating brand accounting practice. For example, Mr Hinton (ASB, 1995y, p30, brackets added), in response to Paul Stobart, said

“...you alluded to the [valuation] methodology becoming more codified. I think that that is probably a fair comment. In fact, the methodologies have codified over the last five, six years or so, but there are still a number of methods.” [He asked:] “Do you see a situation developing, as we have in the surveyors’ property appraisal field, where the methods will

not only be codified, but actually the appropriate methodology in each accepted circumstance will be promulgated so that readers could actually be assured that we would be using common methodology for given circumstances to avoid a situation where we are going to have three brand valuations or even more on a given asset?"

The short answer was 'Yes', but to date no such codification exists.

*To summarise this section*

Not surprisingly the valuation companies were proactive in arguing for the reliability of measurement produced by valuations independently of transactions-based measurements. It was possible that, if the Board could be convinced as the reliability of measurement produced by valuations, they may have been prepared to consider the use of valuations at the initial recognition stage of an asset. However, the issue of what is a reliable measurement within the existing signification structure (Figure 4.3b) is a subjective 'judgement-call' which is currently made in favour of a transactions basis at the initial recognition stage of an asset.

An alternative approach would be to trade-off reliability for consistency, brought about by the codification or the regulation of valuation methods. Underpinning such an approach is the notion of circularity, that is, that valuation becomes the accepted norm, which then may be used to establish a transactions-based value in any exchange. Thus, the previously unrecognised valuation at the initial recognition stage becomes part of the signification structure in a mutually reinforcing manner. Of course, the key words here are 'accepted norm', with each valuation company wishing their valuation method to become the accepted norm.

Finally, we move from box C (social action) to box D (outcomes) in Figure 4.1.

#### **4.4 Outcomes and conclusions**

The structure presented in Figure 4.3(a)&(b) provides the social codes of conduct that guide and order the behaviour of actors in general as well as more particularly in respect of accounting for goodwill and intangible assets. Insofar as such codes of conduct can be said to exist given their abstract nature, they exist independently of any particular actor. Thus, there is nothing tangible about Figure 4.3 (a)&(b) other than insofar as it exists on paper. It is a structure that exists in virtual time and space and one that can be accessed by actors in an instance during social interaction in specific time/space settings. In the case of goodwill and intangible assets, within the existing signification structure, this often occurs at the specific time/space setting associated with a business acquisition.

Actors draw upon standardised elements of stocks of knowledge that enable them to make sense of the signification structure and to act upon it, or even to change it, in the appropriate social setting. In this context and to repeat, the elements of the stocks of knowledge, or what Giddens refers to as interpretive schemes, comprise accounting policies. In theoretical terms “‘Interpretative schemes’ are the modes of typification...whereby they are able to make accounts, offer reasons, etc.” (Giddens, 1979, p83; 1984, p29). When interpreted in the practical terms, “...accounting policies determine which facts about a business are to be presented in financial statements, and how those facts are to be presented...[i.e. “to make accounts”]” (ASB, 2001, p10). In this regard, accounting policies mediate between the virtual accounting structure of Figure 4.3(a)&(b) and the situated social interaction – what Giddens refers to as “modalities of structuration” (Giddens, 1984, p28). Let us summarise how these modalities link social action and social

structure together by reference to the summarised views of the respondents on this matter.

The following outcomes are determined:

- There was debate about which view of accounting should dominate: Box C or Box E, and with it the respective tension between the reliability, but decreasing relevance of transactions-based cost versus the greater relevance, but less reliable measurement associated with a valuations-based approach. Box H encapsulated this tension, a tension that is a longstanding feature of the signification structure. However, the respondents rightly identified that this feature was the root cause for the non-disclosure of internally generated intangible assets. The reason for not moving towards a full valuations approach to accounting, with or without transactions, was the issue of the unreliability of measurement associated with that approach.
- Measurement estimation is a natural part of accounting and can even occur, albeit rarely, at the initial recognition stage of an asset (Box N). However, whenever it comes to a choice between the disclosure of transactions-based cost or an independent valuation the former always dominates, as we saw in the exploration and software examples from the respondents. There may be discretion to do otherwise but in practice social action and social structure are mutually reinforcing in asserting the dominance of transactions.
- Reliability of measurement, being a relative concept, is dependent on one's perception of 'sufficiency'. For many respondents various valuation approaches were sufficiently reliable, whereas the Board remained largely unconvinced. A key aspect in this regard was the need to identify the value of an intangible asset from the value of a business. It became obvious that in the absence of specific recognition

criteria for intangibles it was often difficult to separate the two values in terms of their separable recognition as well as separable measurement.

- Some respondents sought to avoid the tension at the heart of the signification structure by maintaining the reserve write-off approach to accounting for intangibles. There was consistency in this approach because internally generated and purchased intangibles were expensed, albeit below the line rather than as a P&L expense. Yet, there were a few respondents who thought that intangibles should be expensed above the line. The approach was humorously dismissed by the Board as being the ‘biggest of baths’ and was not even advanced as a possible accounting option in the discussion paper, despite being a ‘reliable’ approach inside the signification structure. One suspects that part of the reason for this response was that it negated a contrary predisposition of the Board towards asset-based approaches and both perpetuated (below the line) and enhanced (above the line) the respective problem of historic and current profit depletion.
- There was a further suspicion associated with the reserve write-off approach and the contrary predisposition of the Board towards asset-based approaches. First, write-offs removed at a single stroke the issue of ‘life expectancy’ and therefore the issue of impairment, that is, FRS11 implemented just one year after FRS10. Further, it was a ‘reliable’ approach falling within the signification structure: write-offs being transactions-based whereas impairment reviews are valuations-based.
- The definition of an asset allows the use of mixed measurements through the term “future economic benefits” provided they result from “transactions or events” – a feature of the signification structure (Boxes L,M,N). However, such measurements do not allow one to distinguish between assets and expenses – also, a feature of the signification structure. One can conclude that measurement, and the reliability



thereof, dominates in this structure to the exclusion of asset recognition other than on the basis of a measurement. Yet, as referred to in chapter one, asset recognition is logically prior to asset measurement.

- The mix of measurement bases, cost and values, is present in the definition of purchased goodwill (purchase cost and fair valued assets), leading one to surmise that the nature of the purchased goodwill “difference” is simply a mismatch between measurement methods.
- Some respondents felt that if the use of valuations is simply a question of sufficiency then the Board should consider codification of such measurements so as to make them sufficiently reliable for accounting purposes. Whilst this was not considered in respect of FRS10 a first step could be said to have been taken in this direction on the issue of impairment, in FRS11. Speculatively, it would seem that there is a willingness to embrace a use of valuations but always subject to the reliability caveat.

## **Chapter five – Legitimation**

### **5.0 Introduction**

According to Macintosh (1994, p174) legitimation structures are a social system's:

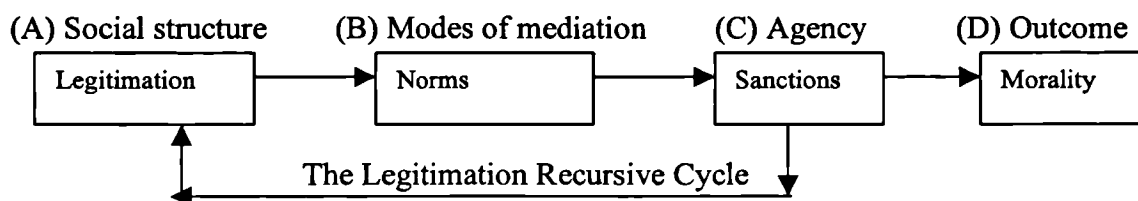
“...collective conscience or moral consensus. They constitute the shared set of values and ideals about what is regarded as virtue, what is to count as important, and what ought to happen in social settings. They also designate what is considered immoral, what is to be trivialized, and what should not happen.”

The purpose of legitimation is to ensure that there is a fit between the actions of the individual actors and the norms of the collectivity. Those norms of behaviour are given societal support because they are perceived to be norms that are moral and therefore support the well-being of society, specifically, in the provision of relevant and reliable financial information. Thus, there is a moral dimension to the social action of accountants and with it, a moral obligation to maintain the norms of the collectivity. The norms of behaviour are not derived over time only from coalescent custom and practice because of the ease with which individuals could detach themselves from such a social structure. Instead, the process of legitimation structures the norms of accounting behaviour through normative rules and, where necessary, sanctions transgressors of those same rules. Those normative rules, in the first instance, legitimate the Board as a morally responsible entity intent on providing a true and fair view of financial reality. That reality is constructed according to the signification structure and the purported truth and fairness of that construction will not only tend to dominate in practice, if necessary, power will be exercised to ensure the dominance of it.

The process of legitimation occurs as a recursive cycle at the levels of social structure and social action and the modes of mediation between them. This is presented generally in Figure 5.1, Boxes (A),(B),(C)) and then in detail in Figure 5.2. The purpose is to explicate

the manner in which the accounting profession legitimates its portrayal of financial reality generally and specifically of goodwill and intangible assets with a view to establishing some outcomes (see Figure 5.1, Box (D)).

Figure 5.1:



(Adapted from Macintosh, 1994, p173)

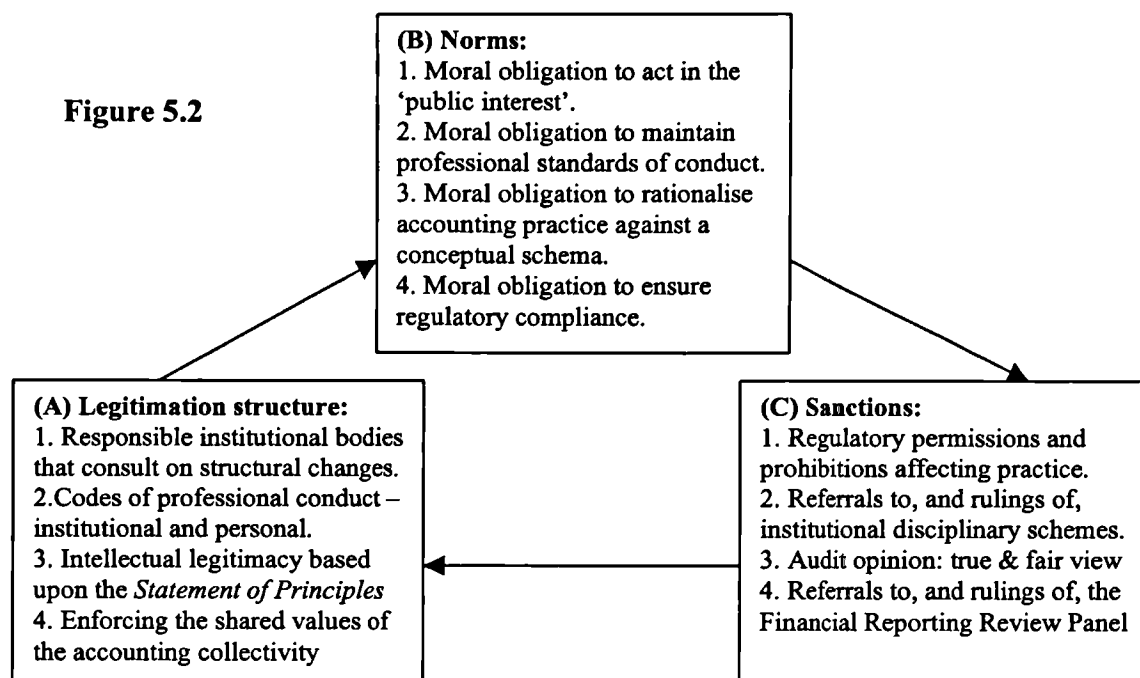
Two features, attached to the “modes of mediation” in Figure 5.1, should be highlighted.

First, moral obligations are attached to accounting norms of behaviour, that is, to the manner in which actors:

“...comply more or less fully with a standard of conduct; the manner in which they obey or resist an interdiction or a prescription; the manner in which they respect or disregard a set of values” (Foucault, 1985, p25).

And, second, the norms of behaviour (Box B) can be translated into normative rules of conduct (see Macintosh, 1994, p174). The normative rules specify in broad terms how one may action (Box C) the shared value system presented by the legitimation structure (Box A). Normative rules therefore have a pivotal role to play in the interaction of the legitimation structure and the social action of sanctioning. It is for this reason that the sectional content of this chapter will follow the four norms presented in detail in Box B in Figure 5.2. Also, that the normative rules (in this chapter five) governing what *should be* normal behaviour may be validated, or not as the case may be, by *what is* in terms of the dominant interaction of social structure and social action (in chapter six). These norms of behaviour will be addressed in the four sections 5.1 to 5.4, below. The final section 5.5

will address the outcomes from this process (Box D, Figure 5.1). First, let us summarise the content and the links between the four normative rules depicted in Figure 5.2.



Let us consider, sequentially, each norm (or points 1 to 4 in Box B) and outline the linkages to social structure (Box A) and social action (Box C). Although there may situations where the four points in each box and between boxes, above, are mixed together, (for example, professional status (Box A, point 2) could be said to affect most of the norms in some way (Box B)), the analysis is mainly presented as four separate cycles (for example, Box A point1 linked to Box B point1 linked to Box C point1) for each of the four points, sequentially, in the three boxes of Figure 5.2.

First, there is a moral obligation placed upon the accounting profession to fulfil its societal role in the domain of financial reporting, notably in the provision of regulatory standards that are supported by society. This societal role is seen to be 'acting in the public interest': for the good of society, including accountants themselves (Box B, point 1). The process of

‘support’ relies upon institutional structures that are seen to consult the views of the society they purport to serve in the domain of financial reporting (Box A point 1). The purpose of consultation is, first, to be seen to be acting in a morally responsible manner and, second, to achieve a consensus in the construction of an accounting standard. Obviously, most of the consultation tends to involve responses from those who are inclined towards developments in accounting and, therefore, the support of society will be less than a universal view. Nevertheless, the resultant regulatory structure, once complete, has attached to it a moral obligation to ‘support’ its content even though individual ‘acceptance’ of it may be a reluctant one. As such, what really matters from an accounting perspective is the ability to construct specific regulatory permissions and prohibitions in the choice of accounting methods (Box C, point 1) so that they may be linked to a consensus position on an issue – a positive reinforcing cycle (Boxes A to B to C). That may be the societal expectation, but a negative cycle may also exist where the constructed permissions and prohibitions in an accounting standard are detached from the consensus to be derived from the process of consultation – to be addressed in chapter six. It then becomes questionable as to whether accountants are then acting in the public interest.

The first norm, above, is addressed in section 5.1, below.

Second, there is a moral obligation placed upon the accounting profession to select, educate and train persons who are able to construct, interpret and present relevant and reliable financial information and to sanction those who are unable to do so, wilfully or otherwise. The societal expectation for an accountant to behave ‘professionally’ (Box B, point 2) is backed by institutional social structures that regulate his/her behaviour (Box A, point 2) and, at the same time, personally sanction those who would break the norms of the

collectivity, that is, those who are deemed to have acted unprofessionally (Box C, point 2). The underpinning morality is that the professional person, and the professional institute to which they belong, are moralistic, socially responsible entities working in the public interest. Those individuals who are found to have acted immorally will consequently face the disciplinary procedures of those institutes to which they belong.

The second norm, above, is addressed in section 5.2, below.

Third, there is a moral obligation placed upon the profession to establish a coherent, rational, consistent and reliable conceptual framework in which to account. The purpose is to objectify, as far as possible, the piecemeal process of constructing financial reality through accounting standards so that the 'sum of the parts' fits into a recognisable 'whole' schema. Hence, the accounting profession seeks to legitimate accounting practice around a shared value system, the *Statement of Principles* (ASB, 1995b, 1999) (Box A, point 3), so that the norms of accounting behaviour are benchmarked and rationally based around that conceptual schema (Box B, point 3). As we saw in respect of the signification structure this is largely transactions-based. That said, the social construction is inherently subjective, for example, in respect of the policy decision to adopt a mixed measurement basis to accounting. Equally, there are instances where principles and rules conflict with each other and choice has to be made as which one will dominate, also, where accounting practice is not guided by any rule at all, as with brand accounting. Equally, there are instances where the principles point to the portrayal of an economic picture of financial reality but the individual rules prevent aspects of that picture from being disclosed, as with many internally generated intangible assets. Thus, the act of sanctioning what will or will not constitute a true and fair view of financial reality is largely a matter of judgement, initially

according to the principles and rules of accounting, but ultimately on the basis of an audit opinion (Box C, point 3).

The third norm, above, is addressed in section 5.3, below.

Fourth, there is a moral obligation placed upon the profession to ensure that accounting practice conforms to regulatory permissions and prohibitions (Box B, point 4). Also, where this does not occur, that enforcement mechanisms (Box A, point 4) are in place in order to correct the immoral action according to established norms of accounting behaviour. It should be noted that enforcement here is about corrective action through the rulings of the Financial Reporting Review Panel (Box C, point 4) not punitive action against the individual accountant (the second norm, above). The two types of sanctioning do not necessarily occur together except where fraud or serious malpractice also occurs.

The fourth norm, above, is addressed in section 5.4, below.

### **5.1. Societal role: The first normative rule**

The accounting profession has a moral obligation to regulate the practice of accounting, which has the support of both society and its members.

First, legitimacy can be conceived of as the attainment of congruence between the actions of the accounting collectivity as endorsed by a high degree of compliance with the regulatory structures proffered by powerful institutional bodies – to be addressed in section 5.1.1. Prominent amongst these bodies are those regulatory structures advanced by the State and the profession nationally, though, increasingly, European moves towards tax

harmonisation, accounting standard harmonisation and, of course, monetary harmonisation, means that the Board's societal role, nationally, is subject to domination, internationally (to be addressed in chapter six).

Second, legitimacy can be conceived of as the attainment of congruence in the values of the national accounting collectivity as obtained by the Board following a standard setting consultation process. By being consultative the Board is seen to be acting morally, that is, in the public interest as a socially responsible institution (to be addressed in section 5.1.2).

#### **5.1.1. The societal role of accounting and accounting regulation.**

Less than two hundred years ago there were no professional accounting institutes and therefore no related regulatory framework within which to account. Whilst double entry bookkeeping was firmly established it was just a technique that would record fraud and omit error depending on the competency and morality of the bookkeeper. Foster (1836, p4) commented in respect of double entry accounts that they are:

“...exposed to all the moral and mental imperfections of the accountant: They are neither exempt from the defects of ignorance – the errors of indolence – or the practice of fraud – and frequent and careful investigations on the part of the proprietor himself are scarcely sufficient to render him secure from such evils.”

In 1844, the Joint Stock Companies Act was enacted against a background of societal pressure to protect investors from unscrupulous promoters of dubious ventures and from those who would adopt suspect accounting practices, such as paying dividends out of capital. The 1844 Act replaced the medieval system of incorporation by Charter with incorporation through a system of registration. This included the requirement to present audited accounts at shareholder annual general meetings. The Joint Stock Companies Act 1855 also introduced the principle of limited liability for such companies. However, the



Joint Stock Companies Act 1856 abolished the compulsory accounting and auditing requirements of the 1844 Act. The subsequent voluntary disclosure of accounts was backed up by the Punishment of Frauds Act 1857 but the overall emphasis at this time was that shareholders/creditors and the promoters/directors should look after their own interests by negotiating for accounting and auditing requirements. In other words, there was an unwelcome trade-off between fraud prevention through greater public disclosure of information and what was then seen as a violation of the investors' right to privacy. However, the trade-off between the need for privacy and the 'public interest' would always be under strain and thirteen years later, the Companies Act 1879 required banks who adopted limited liability status to also undertake annual audits of their accounts. Once the public interest ideal dominated over the private interest ideal the scene was set for the development of a profession that legitimised its position in society by fulfilling the social need for accurate and reliable financial information. It is this role which it is in the profession's private interest and society's 'public interest' to perform.

The problem with accounting attempts to legitimate their position in society by a 'public interest' standard is that the standard itself is both uncertain and changeable according to public opinion. For example, Banfield (1958) in his book *The Moral Basis of a Backward Society* emphasises some commonality of interest:

"...a decision is said to serve special interests if it furthers the ends of some parts of the public at the expense of the ends of the larger public. It is said to be in the public interest if it serves the ends of the whole public rather than those of some sectors of the public."

Thus, accountants can be said to be operating in the public interest if, in addition to their natural desire to be remunerated (their "special interest"), they are also seen to be fulfilling their responsibilities to the community, that is, as the principal providers of financial information in an efficient and effective manner. The potential for a conflict of interest in

the pursuit of 'private greed versus public need' is obviously present in this statement.

Consider, for example, the comments of the Accounting Foundation Review Board (2002, p54) who in quoting from the DTI's (1998) *A Framework of Independent Regulation for the Accountancy Profession*, (see [www.dti.gov.uk/cld/framework](http://www.dti.gov.uk/cld/framework)) had this comment to make:

"There is a legitimate and substantial public interest in arrangements to ensure professional activities in whatever field are conducted effectively and with integrity. The public is not always well placed to assess directly the quality of the professional services on offer, but has a reasonable expectation that it can rely on the professional title. Equally, the members of the profession have a powerful long term self-interest in maintaining the reputation of the profession as a whole. There is, therefore, a close alignment between public and private interests in maintaining and developing rigorous professional standards."

There has, for example, been a move in recent times towards the pursuit of the 'public interest' ideal. This has manifested itself in developments such as The Nolan Committee on Standards in Public Life (1995), the protection of consumer rights vested in bodies such as the National Consumer Council, as well as, social pressures for greater accountability.

For example, in a report by the ICAEW (1997) on *Added Value Professionals: Chartered Accountants in 2005*, they state:

"Companies will also have to pay more attention to the needs of all their stakeholders – who, in turn, are likely to become more assertive. As a result good links with employees, customers, suppliers and the local communities in which they have a presence will be important."

It could be argued, for example, that the recently proposed expanded role for the Operating and Financial Review in published accounts represents a move by the profession to serve the public interest in terms of perceived financial information needs that are currently missing from the public domain.

In contrast, Willmott (1990, p49) suggests that the concept of acting in the public interest:

“...begs what is perhaps the most central question of politics: do the objectives, procedures and policies embodied in the structure and regulation of social and economic relations benefit the ‘many’; or do they , in the name of public interest, disproportionately advantage a minority of unnecessarily privileged individuals, members of powerful interest groups or a dominant class?”

A capitalist would present the efficient market viewpoint in that the public interest is best served by private individuals who are supplied with reliable and comparable information and who make decisions that are in their own best interest. Willmott (1990, p49) argues that the accounting profession supports this general stance:

“The accounting profession has thereby contrived to fulfil its espoused commitment to the public interest by assuming and upholding the legitimacy of the private interests of investors and business.”

Despite the declared objective of serving the public interest, the accounting and auditing profession during the nineteenth century was still in a fledgling state with a poorly defined role in society for audit work that was legitimised partly by statute (as previously described) and partly by negotiation. For example, there was no requirement under the 1844 Act for auditors to be independent. It was not until the granting of a Royal Charter to the Society of Accountants in Edinburgh and to the Institute of Accountants and Actuaries in Glasgow in 1853-55 that the accounting profession ‘came of age’. These Charters were granted against a background of longstanding professional repute for competency in auditing and insolvency work. However, this reputation was earned through a common sense approach to such work rather than being based on a rational conceptual schema or some legislation that attempted to ensure consistency of approach. In contrast, from an investor viewpoint, the primary concern was the detection and prevention of fraud irrespective of such conceptually based concerns. According to Sikka, Puxty, Willmott and Cooper (1992, p15):

“...the widespread expansion of audits was promoted by the state. It came at a time when the forces of capital expanded at an ever increasing rate and a demand was created for the

appearance of the limited company as a vehicle for capital accumulation and economic growth. Among the safeguards from fraud built into the registered company was the audit function. The profession embraced fraud detection and investor protection to achieve social privileges for its members.”

In the 1920s, the Royal Mail Steam Packet (RMSP) case, as it was known, showed that accounting malpractice and inadequate disclosure was still prevalent despite decades of concern and legislative responses to the issue of fraud. The RMSP company manipulated its reported profits through inter-group transfers that were not disclosed in the holding company accounts as well as using reserves to continue paying dividends from a company that was technically insolvent. Linked to this issue of consolidated accounting, the Society of Incorporated Accountants during the 1930s advanced the case for the mandatory disclosure of subsidiary profit and losses on the balance sheet of holding companies. This attempt failed partly because the Board of Trade resisted such moves. The basis for this resistance was similar to that advanced in respect of the 1844 Act, namely, that such disclosure should be a matter for negotiation. However, by 1939 it was a condition of a Stock Exchange listing for company consolidated accounts to be produced, a requirement subsequently enacted in the Companies Act 1948.

The period immediately after the second world war saw no major legislative changes to the 1948 Act partly because any problems in accounting tended to manifest themselves in times of economic downturn which were generally not present during this period.

However, by the late 1960's the ability of accounting information to accurately inform investors was again called into question in cases such as the GEC takeover of AEI in 1967 and the aborted takeover of Pergamon Press by Leasco in 1969. In the case of GEC/AEI, a forecasted profit of £10m pre-takeover turned out to be a £4.5m loss after takeover, the £14.5m difference being matters 'substantially of fact' (£5m) and 'matters of judgement'

(£9.5m). The successful takeover of AEI based, to some extent, on suspect accounting information brought the profession into disrepute in terms of serving the public interest or more accurately in this case, the investors' interest. The public interest ideal is obviously one that is subject to change as society itself changes over time. Robson (1991, p557), for example, argued that the growth in take-overs and mergers from the 1960s onwards led to the employment of accountants as profit forecasters and financial advisers on such matters. It was the interpretation and/or augmentation of historic account figures as "investment signifiers" (p559), being based on current values, which is where the problems arose.

Robson (1991, p563) commented as follows:

"The growth of financial calculation and the professionalization of investment analysis increased the "value" of accounting reports upon which investment calculations relied. As particular accounting and auditing failures...occurred, their effect was to contribute towards a new site of problematization relating to accounting and auditing techniques, a discourse which articulated their inadequacy in the name of the "investing public"."

A response to such developments was to regulate accounting practice through the professional institutes but within the boundaries established by the Companies Acts. Yet, at the same time, the legitimacy of the profession as the primary financial information provider in society was undermined by such cases.

Prior to the existence of accounting standards, the ICAEW used to issue Recommendations on Accounting Principles without reference to the views of the other professional accounting institutes and often without prior research being undertaken on the topic. There was no obligation to consult on the content of these recommendations, nor was there any obligation on the collectivity to follow them. Inevitably, there was considerable variation in accounting practice that eventually prompted the ICAEW in 1969 to advance the issuance of accounting standards. A year later, the ICAEW established the Accounting Standards Steering Committee (ASSC) whose objectives were, amongst other matters, to

reduce the variations in accounting practice and to encourage greater disclosure, such as in respect of accounting policies. Also, to expose, discuss and, where necessary, improve the proposals for accounting standards with a view to establishing a consensus on them. The key feature, however, was that such developments appear to have been 'a damage limitation' response to public concerns and to governmental concerns as to the reliability of accounting information:

"The present arrangements for setting accounting standards in the UK were established at the end of the 1960s in the aftermath of the considerable controversy and debate surrounding a series of company collapses and take-over battles (Zeff, 1972). The standards setting programme very quickly ran into trouble however, not least in relation to its stated aim of narrowing the differences and variety in accounting practice (ICAEW, 1969). This was most dramatically exemplified in the case of the inflation accounting debate (Whittington, 1983), but the same difficulties also applied to a number of other areas of accounting standardisation" (Burchell, Clubb, Hopwood, 1985, p393).

Indeed, on inflation accounting, the government of the day set up the Sandilands Committee in 1975, which was seen by many as a direct threat to the independence of the accounting profession to regulate its own affairs. It should be noted at this juncture that accounting regulation still remained in the hands of the accounting profession. In other words, the only credible source of threat (the State) to the ability of the profession to independently legitimate its position in society was seriously considering powers to change the social structures of the profession unilaterally. It was a position that was successfully resisted by the accounting profession.

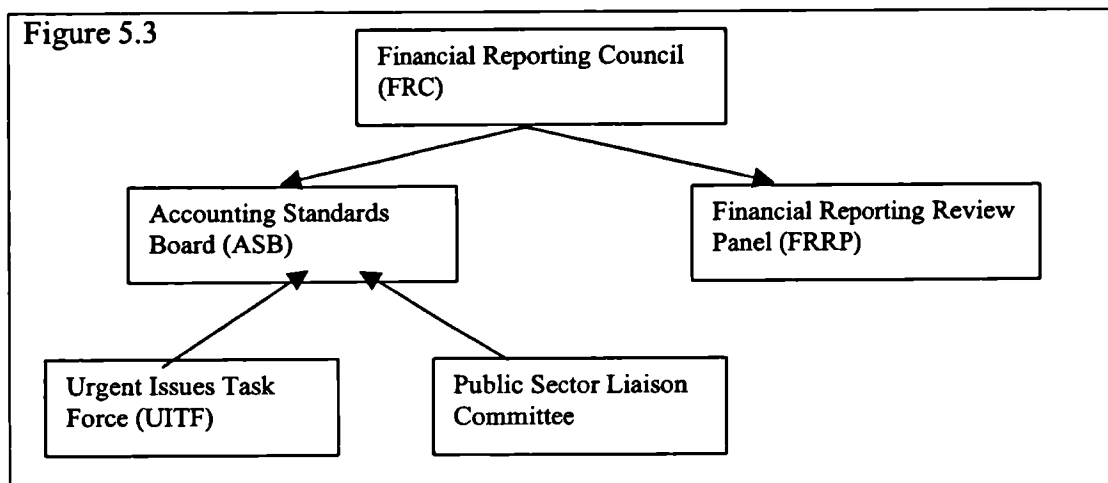
In 1976 the Accounting Standards Committee (ASC) was established as a joint committee of the Consultative Committee of Accounting Bodies (CCAB), comprising the six governing bodies of accounting in the UK and replacing the Accounting Standards Steering Committee (ASSC). The ASC's members were originally nominated by these governing bodies and charged with the task of creating Statements of Standard Accounting

Practice (SSAP). There was no statutory basis to SSAPs. SSAPs were created after a lengthy consultation process that was preceded by an exposure draft. All standards were subject to approval by the CCAB governing bodies. Practical non-compliance with them was left to the disciplinary procedures of each Institute. Accounting standards, that are complied with in practice, legitimate them and by association, the body that issued them.

In the 1980's the state became particularly concerned with, what was referred to as, 'white collar crime' or theft from investors. Well-publicised affairs such as those concerning Guinness, De Lorean, Grays, Johnson Matthey threatened public confidence in the City of London and the ability of the State to protect the interests of investors. The State responded, for example, in terms of the Building Societies Act 1986, the Financial Services Act 1986, the Banking Act 1987, the Companies Act 1989 but the incapacity to prevent criminal human behaviour meant that further scandals continued to happen, such as, later on, BCCI and Polly Peck.

In 1987 the CCAB initiated a further report on accounting standard setting chaired by Sir Ron Dearing. The Dearing Report was published in 1988. It recommended the replacement of the ASC with a structure that continued to exist until 2004 – see Figure 5.3. A feature to note is that the ASB, unlike the ASC, has the authority to issue standards directly without the approval of the CCAB. However, some may argue that the Board's position in this regard is only quasi-autonomous because of the 'guiding hand' of the Financial Reporting Council (FRC) and its links to the State. Standard setting has therefore moved from being the prerogative of the accounting profession (through the CCAB) to one that is under the control of a broader-based authority with, where necessary, influential input from the State (through the FRC).

Figure 5.3

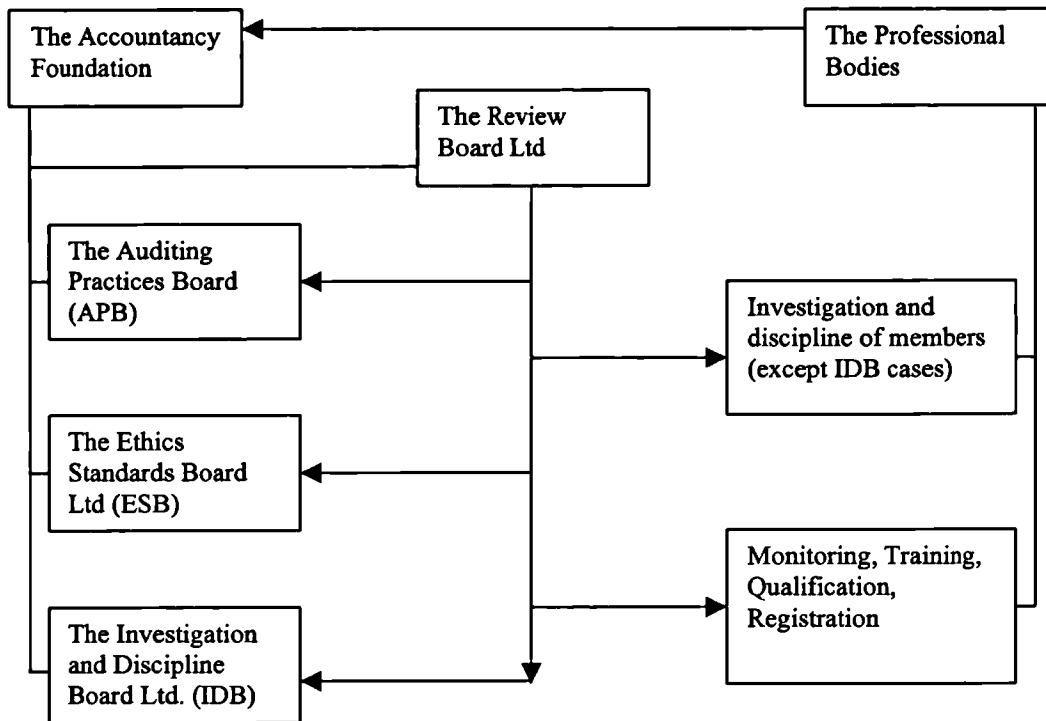


There is now legal backing for accounting standards (The Accounting Standards (Prescribed Body) Regulations: SI No.1667, 1990) both in terms of the Companies Acts 1985, 1989 and case law for companies to state compliance with them in their accounts, also, to report material departures from them. The legitimacy of the Board's standard setting role in society is therefore backed by statute, the Board being a prescribed body under s256(1) of the Companies Act 1985. Accounting standards are themselves given authority in that any departure from them and the reasons for that departure must be disclosed in the accounts, such legitimacy being underpinned by numerous Companies Act 1985 references: paragraph 36A, schedule4 and paragraphs 18B & 49, part1 of schedule9A.

In 2001, the CCAB created The Accountancy Foundation – see Figure 5.4. As a non-statutory, independent body (legally, at least), the purpose of the Accountancy Foundation was to ensure public confidence in the accounting profession by overseeing the profession's systems of investigation, discipline, professional conduct and regulation.



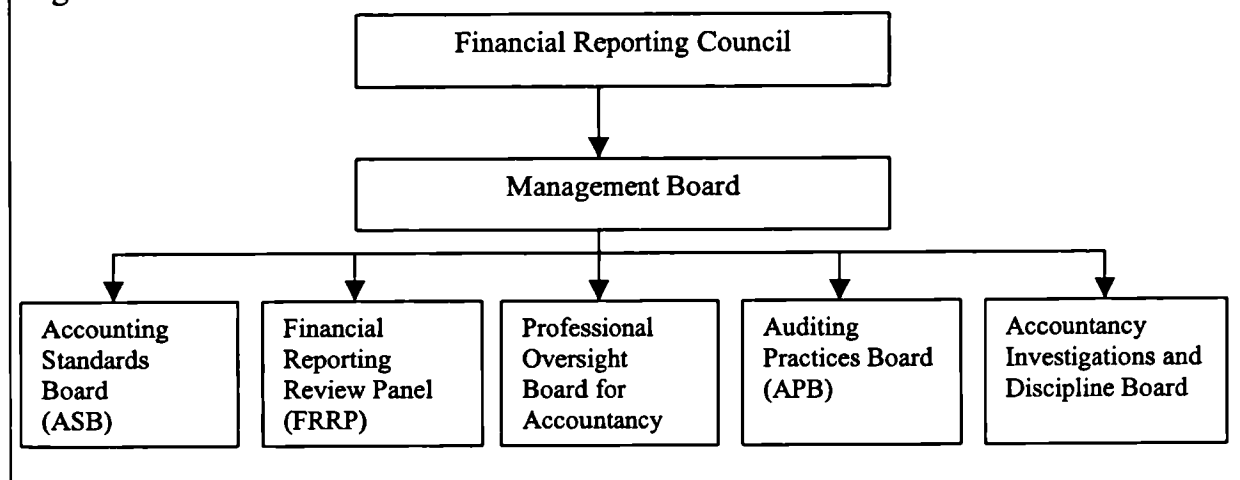
Figure 5.4: The Accountancy Foundation



The Foundation comprised four private companies: the Auditing Practices Board (APB), the Ethics Standards Board (ESB), the Investigations and Discipline Board (IDB) and the Review Board (RB) which occupied a pivotal role in carrying out investigations into the functions of its sister Boards as it saw fit. Whilst this new structure had little to do with the creation and enforcement of accounting standards, per se (Figure 5.3), it is relevant in that the two social structures (Figures 5.3 and 5.4) were eventually amalgamated (in Figure 5.5) to form a reconstituted FRC from 2004 onwards.

The creation of the Accountancy Foundation was yet one more response to the loss of public confidence in financial reporting. However, in a sense it was a response that was too late because many of these bodies now report to the FRC, from 2004 onwards – Figure 5.5.

Figure 5.5



The role of The Accountancy Foundation was first reviewed by the DTI in October 2002.

The DTI decided to keep an “open mind” on the creation and development of an Accountancy Foundation pending reports of the *Coordinating Group on Audit and Accounting Issues* (CGAA, 2003) (to be addressed in section 5.4.1) and the DTI’s (2003) *Review of the Regulatory Regime of the Accountancy Profession* (to be addressed next).

With hindsight, it would appear that the DTI already had in mind the structure presented in Figure 5.5.

The DTI review group’s focus was upon the regulatory functions of accounting and auditing and on new ways of performing them, also, whether the balance between self-regulation and state-regulation was correct. Their recommendations (DTI, 2003, pp6-8), selectively extracted in relation to the issue of legitimation (also, so as to avoid duplication with the CGAA report to be addressed in section 5.4.1), were as follows:

1. “...that the FRC should take on the functions of the Accountancy Foundation, creating a new body, referred to in this report as “the independent regulator””. The FRC comments that it will bring:

“...two key characteristics...independence from government...and broad support in expanding its role into regulatory areas of the Accounting Foundation” (FRC PN72 Press Release 29/01/03).

Yet, in the next sentence, the FRC states that the DTI would lead the implementation team.

The point here is that, whilst the profession and the State were working in partnership on these changes to part of the legitimating structure of accounting itself, change was actually being driven by the State. The purpose, now carried into effect:

“...was to give effect to the recommendations for improving corporate governance in the reports from Sir Derek Higgs and Sir Robert Smith (the Higgs and Smith reports). She said [referring to Patricia Hewitt, Secretary of State] that the FRC would also assume the functions of the Accountancy Foundation (changed in certain important aspects) so that, in addition to corporate governance, the FRC and its operating boards would then have three clear roles [repeated here]:

- Setting accounting and auditing standards;
- Proactively enforcing and monitoring them;
- Overseeing the self-regulatory professional bodies.”

(Financial Reporting Council Chairman’s Report, 2003, para.3, square brackets added).

2. “...that the independent regulator should have clear arrangements for accountability and transparency and should be outward facing in its role.”

These arrangements may be summarised as follows:

- That whilst the chair and deputy chair of the council of the independent regulator would be appointed by the Secretary of State for the DTI, all other appointments to the council and subsidiary boards would be by advertisement. Appointments should be on merit, subject to independent scrutiny, comply with equal opportunities, be transparent and proportional. There would be strong commitment to the principle of lay majorities. This in contrast to the previous institutional arrangements: where many board appointments were nominated. There is legitimacy in being seen to avoid the accusation of cronyism.
- The independent regulator would establish lines of reporting and, where appropriate, the flow of information between constituent boards so as to avoid

overlaps. In particular, the Review Board, would not review the work of the other Boards but instead be outward facing. The implication is that the public interest would be better served in its new independent role as reviewer of the regulatory activities of the professional institutes and for its control of an audit inspection or monitoring unit. These arrangements have now been carried into effect, the Review Board now being reconstituted as the Professional Oversight Board for Accountancy.

- Arrangements for enhancing transparency should include easy public access to information including published programmes of work and published minutes and papers. The public interest is served by greater public access to information.

3. “...that the Auditing Practices Board should take over the professional bodies’ responsibility for setting standards for independence, objectivity and integrity for auditors.” The DTI group also recommended that the APB should be placed on a statutory footing as a recognised supervisory body under the Companies Act 1989, thus emphasising the division between its former professional association and its new linkage to the State as national audit standard setter. The statutory basis legitimates its function in society but at the same time it can be seen as a direct threat to the professional independence of the professional institutes of which it was formerly a part. The argument here is that as the APB is already successfully setting an ethical agenda in pronouncements such as the *Auditors Code*, to be outlined in section 5.2, so it should continue to fulfil that vital public interest role. And that is now the case, as the Ethical Standards Board is wound up and its duties are passed to APB:

“Its responsibilities [the APB] have also been extended to the development of ethical standards relating to independence, objectivity and integrity of auditors...As in the case of the ASB, there is a strong growing international dimension to this work.”  
(Financial Reporting Council Chairman’s Report, 2003, para.11, square brackets added).

4. “...that the long planned Investigation and Discipline Board should be brought into being without further delay to provide, as intended, a demonstrably independent forum for hearing significant public interest disciplinary cases.” The IDB would be underpinned by statute and would have the power to ‘call in’ cases, that is, be proactive. It would also have the significant power to remove the eligibility to audit from both firms and individuals.

However, public concern was expressed about the slowness, transparency and effectiveness of this process:

“We believe that public confidence would be best ensured by making the IDB part of the new, independent regulatory structure. There is also a case for statutory powers to enable it to impose appropriate sanctions on audit firms and individual auditors and we recommend this is examined further. We welcome the IDB’s commitment to the presumption of open hearings. Greater transparency may help defend the process against the perception of slowness, and a continuing focus on how case management can be enhanced once the IDB is operational should help to minimise the time needed to investigate and decide them” (DTI, 2003, p41).

The IDB has now been reconstituted as the Accountancy Investigation and Discipline Board (AIDB) as part of the FRC’s “...new, independent regulatory structure” from 2003 onwards (see Figure 5.5). That said, most disciplinary cases will still continue to be heard by the various institutional disciplinary panels, such as the Joint Disciplinary Scheme (JDS). Thus, it may be argued that the IDB is truly a product of State sanctioned legitimisation structure: major cases attract the majority of public interest and the State wants to be publicly *seen* to be responding to such matters.

The FRC constitutes a direct link between government and the accounting profession even though it is now declared to be an independent regulator. The remit of the FRC has clearly broadened to include the setting of accounting and auditing standards, overseeing the self-regulation of the professional bodies as well proactively enforcing and monitoring standards – an expanded role for the FRRP (to be addressed in section 5.4.2).

In addition to these developments at the national level, the ASB, in particular, is actively pursuing amendments to a number of accounting standards that would see their convergence with international accounting standards. This makes sense in that use of international accounting standards for all publicly traded companies is mandated by regulation 1606/2002 of the European Parliament for all member states from 2005 onwards. It is a move that is also supported by the DTI (2002, paragraph 1.3). Thus, national legislation may be viewed to some extent as subordinate to the EU intention to promote the role of the IASB in its drive for financial harmonisation throughout the European Union. Part of the above convergence policy involves a move towards the use of fair values [1].

#### *Summarising this subsection*

The *de jure* position of the profession is to legitimate its position and role in society through the structure of legal and quasi-legal formalism. This manifested itself, respectively, through statute (notably, the Joint Stock Acts and later on, the Companies Acts) and accounting regulations (notably, accounting standards) with the latter sometimes receiving added legitimacy through case law (see, for example, *Lloyd Chetham v Littlejohn* [1987] BCLC 303 at 313). Whether inspired by the professional institutions of accounting or by the State, the above formalism was seen as being in the public interest. The pursuit of the public interest was directed primarily towards attempts at protecting

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[1] Under Directive 2001 65/EC, section (7) it acknowledges that the leading accounting standard setters in the world are moving away from the historic cost model towards the use of the 'fair value' model. One may imply from this development that the 'balance sheet primacy' viewpoint (see Chapter 4) with its emphasis on economic values appears to becoming the international norm.

investors from malpractice and fraudulent practices: a social action directed toward the construction of formalised social structures that legitimated the position of the profession in the eyes of society.

The *de facto* position has turned out to be somewhat different in that over the decades neither the State nor the accounting profession has been able to fully prevent or protect against accounting malpractice and fraudulent acts. The trade-off in the loss of ‘privacy of information’ to the investor in favour of greater disclosure ‘in the public interest’ does not appear to have worked fully as a crime prevention measure. Thus, a basis on which the legitimacy rests is undermined by the waning support of society and its members. The latest response to events, such as to the collapse of Enron, has been to tie the regulatory bodies and regulatory prerogative of the profession more closely to the State through the FRC and to supranational bodies through, for example, EU directives and international accounting standards. However, it could be argued that this approach is flawed because the problem lies in errant social action whereas the proposed solution lies in changing social structures on the unproven assumption that the latter will deter the former.

#### **5.1.2. Legitimation through consultation.**

By being consultative the Board is seen to be acting morally, that is, in the public interest as a socially responsible institution. Consultation is therefore an important part of the standard setting process.

Historically, a number of implementation steps were present in the drafting a Statement of Standard Accounting Practice (SSAP) (ASC, 1978, p57):

- (a) Preliminary drafting by learned representatives of public practice, industry, commerce, specialist and non-specialist interests.

- (b) Early consultation with the CCAB, technical committees of the professional institutes, those interest groups most affected by the content of a standard.
- (c) Publication of an exposure draft (ED) which is mailed to major organisations and leading accounting journals.
- (d) Comments on the exposure draft will be considered from anyone.
- (e) Later consultation is conducted with various representative bodies whose comments indicate particular problems and difficulties with an exposure draft.
- (f) A proposed Statement of Standard accounting Practice (SSAP) (an amended exposure draft) is sent to the CCAB for their consideration – whose membership are individually responsible for approving the issuance of an SSAP.
- (g) Publication of the SSAP accompanied by a technical release briefly explaining the background, the amendments to the ED incorporated into the SSAP, and substantial comments that have been ignored.

Allied to this implementation process, which itself is partly consultative, is the desire to be seen to promote a social structure that is overtly consultative (ASC, 1978, p56):

- “(a) The consultative procedures should continue to be extended as resources permit.
- (b) Informal discussions with the press should be held.
- (a) The ASC should be prepared to hold public hearings in exceptional cases.
- (b) The ASC should publish a periodical news sheet.
- (c) So far as resources permit, the ASC should publish explanatory booklets.
- (d) The ASC staff should continue to give informal oral guidance.
- (e) The ASC should have the power to issue formal Recommendations and Interpretations although it is to be expected that such documents would rarely be issued.”

In general, “The ASC welcomes public comment on this matter, but failing any clear reasons and consensus for a change, recommends retention of broadly the existing structure, devoting considerably more resources to the consultative process”(p56). Thus, the ASC sought, *de jure*, to legitimate its position in society as a body that was open to the views of others whilst, at the same time, *de facto*, retaining the existing signification structure in the absence of “clear reasons” for changes to it. Later on, as we saw in section 2.7, the discussion paper (ASB, 1993) commenced consultation on the basis of preferences over accounting methods, the existing signification structure being both perpetuated and taken for granted. A subtle form of sanctioning therefore operated in that, for example, there was prohibition on the disclosure of internally generated goodwill and closure on a transactions-based structure that excluded valuations arising independently from it.



Styles (<http://panopticon.csustan.edu/cpa99/html/styles.html>) in commenting on the work of a review group of the ASC said:

“Watts (1980) suggested that compliance [with accounting standards] required that accounting standard setters recognize a public interest aspect of standard setting. He also concluded that standards must be acceptable to the business community not just members of the professional bodies. To gain consensus for standards the Review Group [of the ASC chaired by Tom Watts – later to become chairman of the ASC] recommended expanding membership of the ASC to include outsiders (e.g. users and preparers) ***and adoption of an open deliberation process***. The Review Group fell short of suggesting the ASC operate independently of the CCAB” (square brackets mine, bold italics added).

Two aspects of this comment are pertinent here: the ‘public interest’ ideal (already addressed) and the need, before finalising an accounting standard, to ideally establish a ‘consensus’ amongst users and preparers of accounts derived from a process of consultation and deliberation. The latter suggestion of including non-accountants on the ASC occurred in 1982, a year after the CCAB published the Watts Report on *Setting Accounting Standards*, which recommended, inter alia, such a change.

The Accounting Standards Steering Committee’s (which became the ASC) Statement of Intent on Accounting Standards required the “wider exposure” of major proposals in the development of standards “...to provide an opportunity for appropriate representative bodies to express their views...” (ASSC,1970, p2). The reasons for consultation include the exposure of the views of opposition groups to the ASC policy decisions, to attract the broadest coverage of insight on diverse and complex topics and to be seen to be acting in the public interest in its standard setting role in society. However, historically, the ASC was generally criticised for:

- Not providing interpretations of the accounting standards that it issued.
- The lack of research funding for the development of standards

- The absence of a conceptual framework so as to avoid contradictory standards
- The lack of enforcement procedures.

As a result of these criticisms, the SSAP16 debacle and governmental concerns about non-compliance in general, the ASC was replaced with the ASB and FRC in 1990, following one of the recommendations of the Dearing Report. The process of consultation initiated by the ASC in respect of Statements of Standard Accounting Practice was then perpetuated by the ASB in respect of Financial Reporting Standards.

Before considering the consultation process in respect of the ASB, there is a historical example worthy of explication because it represented unfinished business passed on from the ASC to the ASB, that is, in respect of the public responses to ED47 (ASC, 1990a) and ED52 (ASB, 1990b), as presented in Figure 5.6. Figure 5.6 reveals a situation whereby the process of consultation was more than cursory and appeared to influence the direction of policy in respect of purchased goodwill and intangible assets. Speculatively, it was a policy decision that was mindful of the power of interest groups to undermine the authority of the then newly constituted Accounting Standards Board (the Board).

According to the Board the purpose of consultation is:

“...to take account of the desire of the financial community for evolutionary rather than revolutionary change in the reporting process...” (ASB, 1995b, p8)

and

“...to provide a coherent frame of reference to be used by the Board in the development and review of accounting standards and by others who interact with the Board during the standard setting process” (ASB, 1999, p13).

The process of consultation should not be confused with the desire to achieve a consensus.

Whilst a consensus is desirable, there may be situations where aspects of a standard have to be 'enacted' on the basis of a compromise – Figure 5.6 being one example. Perhaps, as a

**Figure 5.6: The consultation process in respect of ED47 and ED52**

In constructing FRED12 the Board needed to placate the respondents to ED47 and ED52 who had previously opted for capitalisation and annual impairment reviews (see ASB, 1993, para2.3.9). These respondents included powerful interest groups such as the CBI and The 100 Group. Thus, as far as possible, there was a need to accommodate the views of those who might successfully oppose the Board's authority in this regard.

In David Tweedie's opening comments to the public hearings (ASB, 1995x, p3/5) he mapped the political milestones since the introduction of SSAP22 in 1984. The International Accounting Standards Committee proposed the international banning of the reserve write-off approach to purchased goodwill, per SSAP22. This prompted the ASC in 1990 to introduce ED47 and ED52, which proposed the international approach of the capitalisation and amortisation of purchased goodwill and other intangible assets. He highlighted the hostile approaches of the vast majority of respondents towards ED47 and ED52. This left the ASC with a dilemma that was passed on to its successor body, the ASB:

"So the Board was faced with this opposition to the compulsory amortisation and the fact that internationally there was no support for writing off the reserves" (ASB, 1995x, p4).

The consensus on Exposure Draft 47 *Accounting for Goodwill* (ASC, 1990a) obtained by the ASC was that a clear majority was against the use of elimination methods and that purchased goodwill should be capitalised without being amortised. The ASC's proposal that it should be capitalised and amortised over its useful economic life generally not exceeding 20 years was resoundingly rejected by the respondents to ED47. The common feature, however, was the capitalisation of goodwill. It came as no surprise therefore that of the two subsequent discussion paper options, introduced in section 2.7, the subsequent preferred option in the working paper (ASB, 1995a) was a hybrid that encompassed the ASC's view and those of the ED47 respondents, that is, capitalise/amortise and capitalise/impair, respectively. In this sense, the hybrid accounting method ultimately presented in FRS10 was truly the product of a political consensus towards accounting rule making.

consequence, there is no obligation in the *Foreword to Accounting Standards* that the process of consultation needs, for example, to achieve a consensus based on a majority opinion:

(1)"When a topic is identified by the Board as requiring the issue of an FRS the Board commissions its staff to undertake a programme of research and consultation. This

programme involves consideration of and consultation on the relevant conceptual issues, existing pronouncements and practice in the United Kingdom, the Republic of Ireland and overseas and the economic, legal and practical implications of the introduction of particular accounting requirements...

(2) When the issues have been identified and debated by the Board a discussion draft is normally produced and circulated to parties who have registered their interest with the Board...

(3) When the issues require a more discursive treatment a discussion paper may be published instead. The purpose of either of these documents is to form a basis for discussion with parties particularly affected by, or having knowledge of, the issues raised in the proposals...

(4) An exposure draft of an accounting standard (a Financial Reporting Exposure Draft or FRED) is then published to allow an opportunity for all interested parties to comment on the proposals and for the Board to gauge the appropriateness and level of acceptance of those proposals. The exposure draft is refined in the light of feedback resulting from the period of public exposure...

(5) There may follow another period of public or selective exposure prior to the issue of an FRS" (*Foreword to Accounting Standards* – ASB, brackets added).

The Board brings a degree of closure to the consultation process in that it alone is able

"...to gauge the appropriateness and level of acceptance of those proposals..." (above), but not necessarily to follow them. This is a point that will be developed further in chapter six, that is, in the way the Board's view is able to dominate in the construction of an accounting standard.

The social structure of the process was outlined above in the extract from the *Foreword to Accounting Standards*, previously. The social action in this regard is placed, by way of example, in the consultation process leading up to FRS10 since this example provides one of the most comprehensive consultation processes ever undertaken by the ASB. The accounting content of the process was a matter for section 2.7. We are interested here in how the consultation process itself legitimises the standard setting role of the ASB in the eyes of society. In re-reading the *Foreword*, above, the relevant documents would be the discussion paper (ASB, 1993) and FRED12 (ASB, 1996a) prior to the issuing of FRS10 (ASB, 1997). However, this consultation process was unusual in that between the

discussion paper and the exposure draft the Board inserted a working paper (ASB, 1995a) for discussion at public hearings (ASB, 1995x,y,z), held for the first time in the ASB's short history.

A discussion paper invites the comments of potential respondents in a structured manner usually by way of a series of questions and sub-questions. Whilst such questions cannot precondition responses they can be presented in a manner that brings a degree of closure on certain aspects of the matter under discussion, for example, by omission from the questions being asked by the ASB. In other words, the act of sanctioning is not just about punishment; it is also about permission, prohibition and restriction, in this case, concerning the direction of the debate. That said, there is nothing to stop the respondents from commenting on any related matter if they chose to do so. So, for example, some respondents chose to highlight the inconsistency of disclosing internally generated intangible assets whilst at the same time excluding internally generated goodwill, the latter, to repeat, being prohibited (ASB, 1993, p2) from the outset of the discussion.

The discussion paper was set in a historical context: existing legislation, existing standards and existing accounting treatments. In the case of goodwill and intangible assets, the historical context also included the history of previous exposure drafts offered by the ASC, the impact of international accounting developments and the points of conceptual linkage to the then draft *Statement of Principles*. Towards the end of a discussion paper there is usually a summary and indicators of the Board's disposition on the matter. In the case of goodwill and intangible assets, of the six accounting methods considered in the discussion paper, the Board proposed two methods for further consideration.

The working paper (ASB, 1995a), a document unique to the goodwill consultation process, restated the background to the debate first presented in the discussion paper. However, the invitation to comment was now already focused on the single hybrid accounting method, the method to be included in FRS10. Whilst the Board's predisposition for asset-based approaches was clearly evident they, nevertheless, asked (p8):

"Given the Board's attempt to determine whether a consensus on this issue can be found, if your favoured solution to the issue were not to meet with general acceptance, which solutions could you accept?"

The implication here is that the Board may be able to attract a degree of legitimacy from a consensus based on a mixture of the respondents' second choice if not from their first choice of accounting method. Offering a hybrid accounting method (capitalise/amortise with capitalise/impairment) was consistent with this strategy, a strategy, it is suggested, that was mindful of the ASC's previous failed attempts to achieve a consensus on this topic and the consequences that flowed from it.

Normally, following a discussion paper the Board presents an exposure draft of the proposed final reporting standard. In the case of goodwill and intangible assets, the working paper was followed by three days of public hearings (the author attended day two). The style of the hearings was both consultative as well as inquisitorial. The respondent's viewpoint was summarised and then the Board members, selectively and pointedly, addressed the weaknesses of their argument in the time available. For example, most of the brand valuation companies were tackled on the interpretive scheme and the reliability of their alternative valuation-based measurements. These public hearings gave the Board the opportunity to be publicly seen to be acting responsibly by giving expert members of society an opportunity to examine the Board itself. Part of a legitimising strategy is to establish credibility at the personal level as well as for the documentation

under consideration. From the author's personal observation the Board was fairly ruthless in pursuit of the weaknesses of the respondents' comments and it consequently presented an image of knowing exactly what it was doing and where it was going in terms of the content of the final reporting standard.

The layout of an exposure draft attempts to mirror that which would be expected in the final reporting standard. There is usually no need in an exposure draft to restate the background to the earlier discussion paper because the earlier consultation has exposed many of the major points and all that remains are particular issues to be changed arising from that discussion. For example, in the case of FRED12 (ASB, 1996a), there were some amendments carried out in respect of the disclosure of negative goodwill. At this stage, any dissenting viewpoint from the Board itself is also usually published. Thus, the legitimacy to be derived from attempts at achieving a consensus viewpoint has an internal dimension to it (the Board itself) as well as an external dimension (the respondents).

Further changes to a financial reporting standard can be made following the responses to an exposure draft but the intention of the Board is undoubtedly that this last stage of the consultation process should be largely confirmatory of the content of the final FRS. However, part of the problem with a dialectic based on a cycles of consultation (with subordinates) and reflection (by the superior) is that the reflection can be applied selectively – again, sanctioning through closure on 'lines of debate'. Opposition to aspects of this selectivity may be voiced by respondents to the consultation process itself but sometimes with little substantive, practical opposition except in the rare cases of subsequent non-compliance (ref. SSAP16). Thus, for example, in respect of goodwill and

intangible assets, despite overwhelming opposition amongst respondents to impairment reviews, impairment is now an important feature of FRS10.

### *Summarising this subsection*

Consultation is a way of being seen to act in the public interest and of perpetuating the Board's dominant role in society as the primary financial information provider, even though that independent role is under threat from the State (see section 5.1.1). The collective conscience or moral consensus of a legitimisation structure implies some form of consultation process otherwise it cannot be 'collective' and, perhaps, be the result of a 'consensus'. One has to be careful though not to confuse consensus with consultation. There can be little doubt that the Board's consultation process enhanced the legitimacy of what flowed from that process, otherwise, the Board would not have wasted their time in undertaking it. This represents the *de jure* position of the Board in respect of the consultation process. However, whether what flowed from the consultation process was a product of a consensus, or not, is essentially an issue of power, for example, whether 'consensus' was achieved by majority opinion, compromise or by wilful misinterpretation. This is the *de facto* position of the Board to be addressed in Chapter six.

## **5.2. Professional conduct: The second normative rule**

The second normative rule is that the professional institutes have a moral obligation to maintain professional standards of conduct. Hence they should regulate accountants through documented codes of conduct and punish those who would transgress them. The purpose is to engender in the minds of society a degree of trust in the manner in which accountants conduct themselves. That said, an issue here is whether trustworthy personal conduct can be subject to normative rules at all. As Foucault (1985, p28) states:



“A moral action tends towards its own accomplishment: but it also aims beyond the latter, to the establishing of a moral conduct that commits an individual, not only to other actions always in conformity with values and rules, but to a certain mode of being, a mode of being characteristic of the ethical subject...In short, for an action to be “moral” it must not be reducible to an act or series of acts conforming to a rule, a law or a value.”

Whilst the accounting institutes would naturally seek to promote the “moral conduct” and the “ethical subject”, the problem with this stance is that such personalised claims to morality are, perhaps, unreflective of cultural shifts in society that advance the pseudo-scientific legitimacy of technique and rule compliance rather than the legitimacy mainly associated with the operation of personal integrity. Nevertheless, morality is presented by accountants in terms of their independence, integrity and objectivity: - the public persona, perhaps, of an auditor. Confidence in this persona is underpinned by ensuring compliance with statute, accounting regulation, professional codes of conduct as well as a professional education and training. Thus, the mutually exclusive terms presented by Foucault are rejected in favour of a ‘marriage’ of personal standards of professionalism and what may be called regulatory professionalism. For example, the Royal Charter that gave rise to the Institute of Chartered Accountants in England and Wales in 1880 said that it was

“...not established for the purposes of gain nor do the members thereof derive or seek any pecuniary profit from their membership [a personal characteristic] but...aim at the elevation of the profession of public accountants as a whole and the promotion of their efficiency and usefulness [another personal characteristic] by compelling the observance of strict rules of conduct as a condition of membership [a regulatory characteristic] and by setting up a high standard of professional and general education and knowledge [another regulatory characteristic]....”

(ICAEW Members Handbook, 1999, p5, square brackets added)

Such altruism (no “pecuniary profit”) was not formerly revoked (s18) until 1948 when by, supplemental Charter, the ICAEW was granted amongst other matters the power to make bye-laws (s15), to make regulations (s16) and even to amend the supplemental charter itself by two thirds majority of the membership (s17). A key assertion that was made in the

supplemental Charter was that the institutional autonomy granted by the Charter would be in the public interest:

“That the Institute being desirous of furthering the aforesaid objects [of the original Charter] and of serving the public interest desires that We should be graciously pleased to command that as from a date to be fixed by Us a new Royal Charter should be granted to the Institute supplemental to the Original Charter granting to the Institute certain additional powers and privileges and restating certain of the original ordinances of the Original Charter...but subject to any amendments and alterations which to Us may seem desirable.”  
(ICAEW Members Handbook, 1999, p12, square brackets added)

Such autonomy to conduct its own affairs inevitably led to a plethora of rules and regulations governing professional conduct. However, the Institute took care to establish some general principles so that attempts to circumvent any rule would additionally have to show that it was not in conflict with the desired professional persona as outlined above.

These general principles were/are as follows:

1. A member should behave with integrity in all professional and business relationships. Integrity implies not merely honesty but fair dealing and truthfulness.
2. A member should strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.
3. A member should not accept or perform work which he or she is not competent to undertake unless he obtains such advice and assistance as will enable him competently to carry out the work.
4. A member should carry out his or her professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.
5. A member should conduct himself or herself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

(ICAEW Members Handbook, 1999, p214)

In respect of auditors these general principles have been refined further, for example, in the APB's *The Auditors Code* (see CGAA, 2003, annex H, brackets added):

1. Auditors act in the interests of primary stakeholders [usually, shareholders], whilst having regard to the wider public interest...
2. Auditors act with integrity, fulfilling their responsibilities with honesty, fairness and truthfulness...
3. Auditors are objective. They express opinions independently of the entity and its directors.
4. Auditors act with professional skill, derived from their qualification, training and practical experience...

5. Auditors approach their work with thoroughness and with an attitude of professional scepticism...
6. Auditors apply professional judgement taking into account of materiality in the context of the matter on which they are reporting.
7. Auditors' reports contain clear expressions of opinion and set out information necessary for a proper understanding of the opinion.

In both cases, the purpose is to legitimate the respective role of the accountant and auditor as a vital public servants who act in the interest of the investor and the wider public interest because threats to the perceived stability of financial investments can undermine society as a whole.

In addition to codes of conduct there is the requirement for the professional man/woman to be educated and trained in accounting. However, a professional education and training is fairly meaningless in the absence of a declared normative role in society, that is, in respect of financial reporting. Thus, a professional education and training is part of a constructed ideological narrative built around the provision of objective accounting information, which is also seen to be in the public interest to provide. According to Robson, Willmott, Cooper, Puxty (1994, p532):

“Ideological narratives are linked to the discourses of legitimation: stories and histories surrounding the development of particular practices that contrive to portray particular forms of social practice as worthy and legitimate...Official histories typically identify the continuing public service of the “professional” group, or key individuals within the profession, and the increasing effectiveness with which it carries out its public functions...”

Part of the “official history” in respect of “public service” is that an accounting education and professional training ensures that the social practice of accounting remains “worthy and legitimate” in the eyes of the public. Consider, again, the role of a Royal Charter in that regard. The Royal Charter, which gave rise to the Institute of Chartered Accountants in England and Wales in 1880, said:

“That with respect to the admission to membership of persons hereafter desirous of entering into the profession the Petitioners contemplate that...a strict system of examination should be established including a preliminary examination to be held before the candidate for membership enters on service under articles an intermediate examination to be held in the course of his service and a final examination and that no person be allowed to present himself for the final examination unless he has served for five years at least or if he has graduated in any of the Universities of the United Kingdom then for three years at least under articles as a Public Accountant’s Clerk.”

Thus, there is an academic barrier to student entry – another form of prohibition, perhaps? (see Figure 5.2, Box C). Whilst articleship is not applicable to all the professional institutes, there is a common need to record a required level of practical competency prior to full membership. Full membership requires the successful completion of examinations as well as an obligation to continue with post-qualification professional studies. For particular groups of accountants there is a need to prove continuing professional education: those applying for practising certificates, or for fellowship status, or for those who run approved training schemes, or for those who work in the reserved areas audit, investment business and insolvency. The point is that the legitimacy afforded to the professional man/woman needs to be obtained and maintained by education.

The legitimacy afforded by being ‘professional’ is ineffectual without the threat of sanctions through disciplinary tribunals such the ICAEW’s joint disciplinary scheme (JDS). This is because the integrity of a social structure, one that purports to promote ethical conduct, may be threatened by social action to the contrary by some of its membership. Where such individuals fail to act according to the norms of their professional institutes they undermine those social structures, in particular, public confidence in the ability of the profession to support the ‘public interest’ ideal where some members are clearly adopting the ‘personal interest’ ideal, instead.

Accountants, individually, know that if they do not act according to the principles outlined in this section then they may be fined, reprimanded or even excluded from membership – another form of prohibition. The professional institutes have various approaches to disciplining recalcitrant members but a common approach is as follows:

- a complaint is received against a member which is subject to initial review as to substance, evidence and possible mode of resolution – conciliation or formal investigation
- If, after initial review the case requires formal investigation, it is referred to an Investigation Committee who may dismiss or uphold the complaint.
- Upheld complaints may be referred to a Disciplinary Committee who may take the appropriate action outlined previously.
- Appeals are possible after investigation and after disciplinary action has been taken.

JDS tribunal hearings, for example, are chaired by a senior lawyer supported by two accountants and are of a quasi-judicial nature. That said, the rules of evidence do not apply. Most of the evidence is documentary without the need to call witnesses to support their testimony. However, experts may be called and cross-examined by lawyers who represent the parties to the case. A judgement is passed, penalties imposed (where appropriate) and the summary findings are publicised.

The JDS has conducted investigations of high profile cases such as BCCI, Maxwell, Poly Peck and Barings. Sometimes the work of the JDS has to be deferred to the Courts where there is a risk of prejudicing any potential litigation. However, in *R v Michael Chance ex-parte Smith and others* (1995), the Court of Appeal held that a deferral to the courts should only be held in exceptional circumstances. In the process, the Court of Appeal has legitimated the role of the JDS, that is, to be seen to be acting in the public interest on such

matters. The implication is that *prima facie* the courts, in the first instance, would prefer to rely on the expertise of the JDS to investigate, if not resolve, matters. And, indeed, there is considerable expertise to be relied upon.

As well as acting as a deterrent against potential offenders, such processes can be seen to be acting in the public interest and, therefore, are another means of the legitimating the professional status of accountants in society. However, somewhat paradoxically, the need to be *seen* to be acting in the public interest is counteracted by the fact that disciplinary hearings are usually held *in camera*. Also, the need to be seen to be acting in the public interest may be undermined by public perceptions of accountants ‘protecting their own’, that is, through punitive sanctions that may be regarded as being too lenient. Thus, this aspect of the cycle presented in Figure 5.2 may be seen to operate but not necessarily in a positively reinforcing manner.

Sikka ([www.essex.ac.uk/AFM/Research/working papers/WP01-06.pdf](http://www.essex.ac.uk/AFM/Research/working%20papers/WP01-06.pdf), p10/11) was

rather sceptical about the efficacy of the disciplinary process. For example, in respect of the Joint Disciplinary Scheme (JDS) run by the ICAEW, he says:

“The JDS is financed and controlled by the UK accountancy trade associations. They decide the cases that are to be referred to it. The JDS meets behind closed-doors. There are no public hearings. The JDS Panels are made up of partners from other audit firms on the grounds that only they have the particular knowledge to enable them to reach a conclusion. Any conclusions reached by them can provide benchmarks for future investigations and thus have the capacity to haunt them. The transcripts of the JDS proceedings are not publicly available. The evidence received and examined by it is not available for public scrutiny. It does not indicate how it filters and weighs various pieces of evidence or why it neglects or downgrades some categories of evidence. The JDS reports do not list the evidence examined, the questions asked and the replies received. The complainants and the parties affected by the conduct of auditors cannot appeal against the decisions of the JDS, but the accountancy firms can. Before publication, the contents of the JDS reports are shown and negotiated with the accountancy firms, but the same privileges are denied to the complainants. There is nothing in the JDS’s consultation to suggest that it owes a ‘duty of care’ to any of the parties.”

The *de jure* position of the profession is that it acts in the public interest by sanctioning recalcitrant members. The *de facto* position, according to Sikka, above, speaks of a process in need of greater public accountability. Let us consider two such cases.

Mitchell, Puxty, Sikka and Willmott (1994, pp45-49) point to a case study concerning the sudden failure of Polly Peck Plc and the role of their auditors, Coopers and Lybrand. Two auditors faced a disciplinary hearing and were each fined £1,000 plus costs, the maximum under the ICAEW's disciplinary rules. However, as the above authors note by contrast (p48), the income from the administration of Polly Peck Plc alone was expected to exceed £10 million. They comment:

"No other penalties were imposed on the partners or the firm as the ICAEW argued that its rules do not enable it to take any action against the firm. There was no investigation of the overall standards of the firm."

Similarly, the above authors point to a number of investigations of the DTI inspectors and their reported criticisms on audit performance. They comment (pp42-45, square brackets added):

"All the cases cited...have been referred to various disciplinary committees of the profession. The professional bureaucracy has taken on average 1,110 days to report its findings, long enough for the cases to disappear from the public view...[Also,] the monies collected [from disciplinary actions] go on to fund the administrative structures rather than compensate those who have suffered from shoddy audit work. The professional bodies have failed to investigate the overall standards of any of the firms listed...When, questioned about the profession's disciplinary record, the Minister of Corporate Affairs informed Parliament that "no auditor criticised in an inspectors' report has been debarred from auditing as a result of information in that report (Hansard, November 1991, col.345)". This is not perhaps entirely unexpected as partners from the firms criticised by the DTI actually presided on the disciplinary panels."

One can surmise from such circumstances that sanctioning accounting actors in order to be seen to be acting in the public interest is being compromised by the lack of detachment of the parties themselves from this process. Again, only time will tell whether the newly

constituted Professional Oversight Board for Accountancy and, to some extent, the Accountancy Investigation and Discipline Board (see section 5.1.1 previously) will take up some of the challenges raised by Sikka et al.

It would certainly be the Secretary of State's intention to promote the 'public interest' ideal because of the need to maintain confidence and stability in the financial markets. Equally though, in instigating the recent structural changes raised in section 5.1.1, the Secretary of State has to strike the right balance between regulating to protect the 'public interest' and maintaining the professional independence of the accounting profession, including the right to discipline its own members. Indeed, it may be argued that there is an element of self-interest in the State's relationship with an independent accounting profession, which tends to prevent it from intervening in disciplinary matters. Part of the reason for this situation is that the State appears to be reluctant to change a duality of structure (social action supporting social structure supporting social action recursively) that it has been partly responsible for establishing in the first place through legislation and other instruments, for example, the granting of Royal Charters for the professional institutes. Another feature is to ensure that the action of the State does not undermine, through excessive intervention, the confidence of investors in the financial information provided by the profession. This leads to a dilemma for the State in that whilst it would obviously seek to stem the loss in public confidence arising from corporate failures, at the same time, it is reliant upon the conduct of professionally qualified accounting actors whose 'professionalism' cannot always be guaranteed.

*Summarising this section*



Professional norms of accounting behaviour are centred upon a social contract for the provision of financial information, a perceived public good for which the profession receives in return certain monopolistic rights, for example, over standard setting. Access to the benefits arising from those rights is controlled through a professional training and codes of professional conduct established by the accounting institutes and backed by the State. However, it is a social contract that is open to continual change as society changes, particularly where one party is not seen to be fulfilling its side of the bargain, that is, through the continued occurrence of acts of fraud and sudden corporate failure. In response, the profession must be seen to sanction recalcitrant members (or to limit their liability – Arthur Andersen?) but, as section 5.1.1 showed, it is always cognisant of the power of the State to affect structural change should the profession fail to act.

### **5.3. Rational conceptual schema: The third normative rule**

The third normative rule is that the ASB should regulate the overall practice of accounting through a rational conceptual schema against which accounting actors should rationalise their specific accounting practices. A key feature in this regard is the role attributed to a conceptual framework to underpin and guide the construction and subsequent interpretation of specific accounting standards, also, those practices not covered by them:

“In applying accounting standards it is important to be guided by the spirit and reasoning behind them. The spirit and reasoning are set out in the individual FRSs and are based on the Board’s Statement of Principles for Financial Reporting” (paragraph 17, *Foreword to Accounting Standards*, website [asb.org.uk/publications](http://asb.org.uk/publications)).

The *de jure* position is that, again, accountants are seen to be acting in the public interest, in this case, by providing a true and fair view of financial reality wherever possible according to an overarching conceptual framework. That said, the *de facto* reality is that both the schema and what may, or may not, be based on it, are inherently subjective social

constructions. As a result, the 'correct' accounting practice, and the resultant true and fair view, may often be the result of negotiation with the auditor. Thus, sanctioning social action can only be on the basis of an opinion, a formal audit opinion, of what constitutes a true and fair view. It is axiomatic that the opinion itself is also inherently subjective.

Forming an opinion on what constitutes a true and fair view is bounded by social structures, in particular, the defined transactions-based accounting reality presented in the signification structure. The social structure posed by accounting definitions presupposes that compliant social action is undertaken, in practice, in a mutually reinforcing manner such that the norms of behaviour legitimate the existence of the definition. Consider the comments of Hines (1988, p257, underlining added) in this regard:

"If men define things as real, they are real in their consequences. We create a picture of an organization, or the 'economy', whatever you like, and on the basis of that picture (not some underlying real reality of which no-one is aware), people think and act. And by responding to that picture of reality, they make it so: it becomes real in its consequences. And, what is more, when people respond to that picture, and the consequences occur, they see it as proof of our having correctly conveyed reality. Clever isn't it. That is how society works."

Much depends on obtaining a shared view of reality and, of course, this is highly problematic when it comes to the 'picture' created in respect of intangible assets. Where the defined nature of reality is viewed as increasingly incomplete then, any correspondence to 'truth' can be perceived to be equally incomplete. However, according to Gerboth (1987, p2)

"...the existence of definitions matters hardly at all in deciding most issues of real-world consequence. Their contribution is to add brevity to discourse. The attempt to make them convey essential knowledge is a two-thousand-year-old source of obscurantism. Other respected disciplines are not even concerned about the precision of their definitions."

Popper (1962, p19), for example, in respect of science, argues that

“...the view that the precision of science and of its scientific language depends on the precision of its terms is certainly very plausible, but it is none the less I believe, a mere prejudice. The precision of a language depends rather, just upon the fact that it takes care not to burden its terms with task of being precise.”

That said there is still a role for definitions in a narrow sense, such as in the determination of whether a patient is in a persistent vegetative state or not.

The comparison to be drawn, however, is with the legal profession. Legal definitions are a useful basis for instruction but any attempt to reduce judgements to a number of deductions from definitions or other principles could easily lead to the occasional miscarriage of justice. It is for that reason that parties are able to seek equitable remedies where a strict application of ‘principle’ would lead to injustice. Nevertheless, the desire for the logic and structure offered by definitions and principles is deeply rooted in the human psyche, for as Holmes (1897, p466) states

“...the logical method and form flatter that longing for certainty and for repose which is in every human mind. But certainty generally is illusion, and repose is not the destiny of man. Behind the logical form lies a judgement as to the relative worth and importance of competing legislative grounds, often an inarticulate and unconscious judgement, it is true, and yet the very root and nerve of the whole proceeding. In essence, it is the personal responsibility of the individual, whether lawyer, accountant or other professional man/woman, who, in making a decision, searches for the best possible approximation of truth at that point in time.”

The concluding caveat is important because the “best possible approximation” changes with societal change, in this thesis, with the rising prominence of intangible assets in financial reporting. The importance and, also, the weakness of the definition of an asset in this regard were highlighted in the signification structure. It is not necessary to revisit this definition here, rather, to note that this definition was part of a social structure and a historic pattern of social action intended to arrive at a conceptual framework for accounting. That historic patterning has at its heart the political policy choice to adopt a

mixed measurement basis. That mixed measurement basis is facilitated by a broadly based definition of an asset, both of which are at the heart of the conceptual framework presented in the *Statement of Principles* (ASB, 1995b,1999). The historic patterning with regard to this vital feature is worthy of explication because it is against this *de jure* policy stance that the practice of accounting, particularly in respect of goodwill and intangible assets, is legitimated. The reader's attention is, for example, drawn again to the assertion made in chapter one that the defined mixed measurement "difference" that *is* purchased goodwill is simply a mirror, at the micro level, of the mixed measurement basis adopted, at the macro level, for accounting as a whole. It seems reasonable to surmise that how the macro policy was constructed historically may well have a bearing on the defined nature of purchased goodwill today. Let us briefly review that specific historic pattern starting with *The Corporate Report* (ASSC, 1975).

*The Corporate Report* addressed the issue of measurement and concluded that (ASSC, 1975, p80):

"...there are inherent conflicts in the application of accounting concepts in arriving at a dual purpose measure of performance and capital maintenance"

This conflict was expressed in the signification structure in terms of the dominance of the balance sheet over the profit and loss account. The point here, though, is that the profession sought to legitimate against conceptual schema that had "inherent conflicts" in the application of accounting concepts. So, for example, the report regarded as

"fundamental" (p80) that

"...whatever basis of measurement prevails, financial statements should be expressed in terms of a standard unit of measurement,"

but, at the same time, it acknowledged (p80):

“...that no one system of measurement is capable of meeting all the user needs...”

That said, the report also recommended a research programme to develop a workable and standardised system of current value accounting (p81), reinforcing the views of Government at that time.

*A Conceptual Framework for Financial Accounting and Reporting* (Macve, 1981, p13/14)

– the Macve Report named after its author Professor Richard Macve, was set against an historic background of high inflation in the late 1970s. Inflation exposed the weakness of the social structure posed by a historic cost model and encouraged the alternative use of a valuations-based approach, which emphasised capital maintenance. The social action of compliance by accountants was then reinforcing a social structure that was undermining the accountants’ position in society as financial information provider through figures that were perceived to be unreflective of economic reality.

The important contribution of the Macve Report was in the acknowledgement that whatever user need was identified, whatever defined reality was constructed, it would ultimately be based on a political decision:

“Recognition of the variety of user needs and of conflicts between different interests and different rights leads to the view that reaching agreement on the form and content of financial statements is as much a ‘political’ process, a search for compromise between different parties, as it is a search for the methods which are ‘technically’ best” (p52).

The clear implication here is that one is legitimating the social actions of accounting on the basis of a social structure that arises from a political compromise. Thus, the norms of behaviour will also be attended by an element compromise, also, negotiation and dispute.

In 1988, the Institute of Chartered Accountants in Scotland published *Making Corporate Reports Valuable* (MCRV). The report criticised the historic cost model and supported the use of a current value system of measurement. It advocated the portrayal of economic reality, that is, economic substance over transactions-based form and, hence, the dominance of the balance sheet over the income statement. Thus, capital maintenance was emphasised with income being viewed as a reconciling item in the movement of asset values between two balance sheet dates.

In 1989 David Solomons published his *Guidelines for Financial Reporting Standards*. It was an influential paper, the central idea of which was for the profession to move away from historic cost accounting to one based on 'value to the business' and the maintenance of real, rather than monetary, financial capital. However, such attempts to legitimate the position of the profession in society as the provider of 'relevant' information had been seriously undermined by the withdrawal of SSAP16 on *Current Cost Accounting* (ASC, 1980b) five years earlier (1984). The point here is that the profession, at this time, was still trying to select an appropriate measurement basis to meet the needs of users for relevant information that took some account of inflation. And, the search for a measurement basis as reliable as historic cost whilst, at the same time, as relevant as current value continues to date.

Finally, the ASB's *Statement of Principles* was issued in 1999 following an earlier draft of it in 1995. Chapter 1 stated that measurements were "for making economic decisions" (p35) and that the investor was the defining class of financial information user (supported by Solomons, 1989, p32). In contrast, The Corporate Report (ASSC, 1975, p77) broadly defined "users as those having a reasonable right to information..." . Chapters 2 and 3

addressed the reporting entity and the qualitative characteristics of information such as relevance, reliability, comparability and understandability. Chapter 4 introduced the elements of accounting and their respective definitions. Unlike the definitions of assets and liabilities (ASB, 1999, p50, p55; see also ASB, 1995b, p53, p57), the definitions of gains and losses (ASB, 1999, p59; ASB, 1995b, p63) were defined in terms of contributions/distributions to/from the owners (see also ASB, 1995b, p64), whose own interest (ASB, 1999, p58) is defined as “the residual amount found by deducting all of the entity’s liabilities from all of the entity’s assets.” Thus, the definition of an asset (and a liability) occupies a lead position in relation to the recording of gains, losses and movements in ownership interest (this is important regarding the assertion that the balance sheet dominates). In chapters 5 and 6 (ASB, 1999, see also ASB, 1995b ch.4 and 5) the subjective qualitative notion of ‘sufficiency’ was applied to the key issues of recognition and measurement. In the main, transactions-based measurements are deemed to provide ‘sufficient evidence’ for recognition of an element and ‘sufficient reliability’ of measurement. However, such matters relate more to the issue of signification rather than legitimation. Finally, in Chapters 7 and 8 the issues of disclosure and controlling interest were discussed.

The purpose of these principles was

- “...to provide a coherent frame of reference for the Accounting Standards Board to use in the development and review of accounting standards. In particular, it provides a basis for choosing between alternative accounting treatments” (ASB, 1995b, p31). The purpose was to legitimate the principles, and the accounting profession in society as an intellectually-based discipline in its own right.

- The Statement of Principles is also, in part, a statement about the future direction of accounting in the UK. If the social structures posed by reporting standards are to be supported by social actors in practice then it helps to have a supporting rationale for those actions even if some actors actually disagree with it. That rationale firmly embraces the adoption of a mixed measurement basis to accounting.

The first draft of the ASB's *Statement of Principles* was, to repeat, issued in 1995 (ASB, 1995b). It was followed in 1996 by a progress paper called the *Statement of Principles for Financial Reporting – the way ahead* (ASB, 1996d). The economic focus of the 1995 draft of the Statement of Principles was interpreted by many respondents to this document as a return to current cost accounting and the problems of SSAP16. The unusual move of issuing a progress paper was to clear up this apparent misunderstanding by emphasising the current mixed measurement approach to accounting – not current cost accounting. The Board also took the opportunity to restate the role of the principles, as outlined in the previous subsection, to which they added one further means of legitimisation: that of close international collaboration and association with the IASC and the FASB. This was stated in the following terms (p2, square brackets added):

“Despite the difficulties noted above [in respect of the current cost accounting], the comment letters generally expressed support for having a statement of principles to guide the Board in the setting of standards. That support reflects a continued acknowledgement of the need in the UK for a statement of principles, which has been expressed since long before the Board was established and which was specifically noted in the Dearing Report. Moreover, other standard-setters such as the International Accounting Standards Committee (IASC) and the USA's Financial Accounting Standards Board (FASB) already have such statements and are using them in establishing accounting and reporting standards. Indeed, the ASB's *Statement* is based on the IASC's and FASB's statements and its content is similar to theirs.”

Thus the original and revised draft Statement of Principles (ASB, 1995b, 1999) may be replete with socio-political policy choices, such as in adopting a mixed measurement



system, but this inherently subjective social structure may, nevertheless, be objectified through the strength of national and international support (explored in section 5.1). Thus, the possibility of error associated with this social construction does not necessarily matter providing everyone is perpetuating the same error: legitimacy being derived from widespread international ‘acceptance’ of the principles.

### *Summarising so far*

The purpose of definitions and principles (*de jure*) is that any social action that is different from the behavioural norms established by this framework, which will inevitably arise in practice (*de facto*), may be subject to ‘objective’ moral judgement. Underpinning any claim to legitimacy by reference to definitions and principles were two notable features: the role of definitions in the construction of accounting reality and the paradoxical inclusion of subjective policy decisions in a supposedly objective framework [2]. That said the *de facto* position is, generally, that it is through the medium of accounting standards that a subjectively true and fair view of financial reality is constructed by accountants, one that is deemed to be acceptable to the business community at the national and, increasingly, at the international level. Thus, notwithstanding Foucault’s comments previously, legitimacy is often in practice presented in terms of compliance with

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[2] A problem with one group in society attempting to legitimate its role in society by means of definitions and principles is that it can find itself in conflict with the definitions and principles of another group. So, the fact that the Statement of Principles “reach beyond the existing requirements of the law” (ASB, 1995b, p31) means they can sometimes be in conflict with the law. For example, an economic focus to the balance sheet as a statement of value means that that there should be recognition of all gains and losses and not just those which are realised, per sch.4, para.12 of the Companies Act 1985. On the other hand, there is an element of social responsibility attached to any conflict as each party seeks to legitimate its own intellectual stance in a reasoned manner.

accounting rules and techniques. Thus, conceptual doubts over documents, such as the *Statement of Principles* (ASB, 1995b, 1999) and the *Accounting Policies* (ASB, 2001), almost paradoxically are mixed with very specific technical accounting procedures that provide the appearance of objectivity. This viewpoint may be referred to as the ‘principles versus rules’ approach to accounting, the danger being that a preponderance of operating rules substitutes for the conceptual principles and definitions on which those operating rules should have based in the first place. This paradox led Hopwood (1990, p79) to comment:

“Such a juxtaposition of procedural specificity and conceptual doubt enables a degree of ambiguity to enter the accounting realm. Terminology is subject to poor usage and a lack of clarity. Concepts are only loosely related to calculative procedures. As a result, the technical practices of accounting assume a greater significance in their own right. They are not mere reflections of more general concepts. The practices of the craft cannot be distilled from theories. Indeed, the technical practices cannot even be mastered at a conceptual level. It is necessary to adopt an experiential approach to training, focusing on mastery of the specific calculative practices which constitute the craft and a slow inculcation of the conventional rationales which are used to relate them to the more general objectives which are claimed on their behalf.”

This paradox remains the case to date, the balance shifting towards a more principled approach to accounting:

“I think Enron has probably made the Americans realise that sometimes, and I emphasise sometimes, detailed rules give rise to loopholes. And ill-intentioned people sometimes exploit loopholes. Therefore on balance, perhaps it is preferable not to create loopholes by creating rules. I think the Americans are genuinely now starting to reconsider some of their more detailed rules and that means that we can hope that we won’t get too much pressure internationally for the IAS to be too detailed” (Mary Keegan interview by Daisy Downes [www.icaireland.ie/Accountancy-Ireland/articles/Jun02](http://www.icaireland.ie/Accountancy-Ireland/articles/Jun02)).

Finally, despite the inherently subjective nature of legitimating a true and fair view of a financial reality based upon a conceptual framework comprising definitions and principles, there, nevertheless, needs to be a process of sanctioning that viewpoint as a reasonable approximation of the truth. The audit function exists because there is a need to prove (or more accurately, have an opinion on) the validity of financial statements produced by

those who are accountable, initially on behalf of investors but also in respect of the maintenance of the economic well-being of society as a whole. The related argument is that public accountability without audit is not possible particularly where company operations are substantial and complex.

Proving the validity of financial statements against subjective definitions and principles, and abstract terms such as 'a true and fair view' makes the task of auditing equally subjective. Consequently professional auditing standards (rules) are established in order to legitimate auditors in the eyes of society as a socially responsible group in exactly the same way that accounting standards are established to legitimate accountants and the practice of accounting. Those rules seek to demonstrate social responsibility by focusing on such matters as independence from the matter under investigation, freedom of the auditor from investigatory and reporting constraints and other standards of personal professional conduct (section 5.2) and professional performance.

The process of auditing is important, in particular, in the collation and interpretation of evidence in support, or otherwise, of management's assertion that the accounts present a true and fair view of the financial situation of a company. This process is about balancing the cost of conducting an audit against the perceived risk of error and/or malpractice. In this regard, strict compliance with accounting rules is perceived to be less risky than those practices that not covered by the rules at all. Thus, before an audit even commences, effort is expended in ascertaining the 'weak areas' of a company's financial control systems (control risk) and those aspects of it which deal with material amounts of money (material risk). Ultimately, the process is about the risk of not detecting errors from the evidence

gathered (detection risk) and, in this regard, this will involve an element of professional judgement and experience of the operations under review.

Equally, there is not much point in undertaking the process of audit if there is no formal channel of communication to declare the results of that process. Communication is about clear expressions of opinion and the information necessary to form that opinion as expressed in the annual report and accounts. The audit report is one aspect of a financial reporting 'package' that includes non-auditable elements such as the Director's Report. The auditor has a duty to ensure that the overall presentation 'package' is not in conflict with specific elements of it. This situation can present problems, for example, a company experiencing liquidity problems may find that an adverse audit opinion exacerbates those problems in terms of creditor confidence. The communication of opinion can be powerful legitimating device that 'all is well' with a company but it also has the power to do serious damage to a company – to be addressed in chapter six.

#### **5.4. Enforcement: The fourth normative rule**

The fourth normative rule is that there is a moral obligation placed upon the profession to ensure compliance with the rules of accounting through the process of auditing and other enforcement mechanisms.

Many of the ground rules for determining 'acceptable' norms of auditor conduct have been created by the Auditing Practices Board (APB). Post-Enron, these norms have been augmented by other structural changes which have, in large measure, been sponsored by the State (see Figure 5.5 and section 5.4.1, below). Structural change is seen by the State as

a way of directing the related social action of auditors so as to reduce the opportunity for the future occurrence of a UK version of the Enron debacle.

Where the accounting representation cannot be agreed upon, or where it is inappropriate to do so (eg. In the case of fraud), then individual actors and companies may face sanctions from institutions such as the Financial Reporting and Review Panel (see section 5.4.2, below). At the level of social action there is an expectation of compliance with the accounting and auditing rules such that censure through the FRRP is a minority occurrence. This expectation manifests itself in terms of either a majority 'consensus' or majority 'passive compliance' in practice, legitimacy being afforded by the resultant consistency and comparability between accounts.

#### **5.4.1. Audit structures**

The Auditing Practices Committee (APC) was a body created by most of the professional institutes in 1976 with, inter alia, the following purpose: to "satisfy our critics in political circles and outside" (APC, 1978, p50). The driving force behind the creation of the APC was the same as that which led to the creation of the ASC in the same year, namely, severe criticisms of the accounting profession following corporate collapses that occurred without warning. This situation led to the development of auditing standards and ethical guidelines. Like the ASC (see section 5.1.1), the APC was responsible to the professional institutes and thus, professional independence was maintained independently from the State.

As with the change from the ASC to the ASB in 1990, so too, the APC changed to the APB (Auditing Practices Board) in 1991. The reason was, again, that the profession needed to be seen to be responding to concerns about corporate failures and the detection

of fraud. Like the ASB, we can see the involvement of the State in respect of the APB's constitution and operation, most notably, through the Companies Act 1989. This Act enhanced the independent role of the audit profession (s.27/28) in the way it regulated its members as a recognised supervisory body (RSB) under s.30(1) and in the way it was to enforce rules as a recognised qualifying body (RQB) under s.32(2). It meant that, as with the parallel case of the ASB, the APB's auditing standards were effectively mandatory. Previously, the APC could only issue audit standards and guidelines with the permission of the CCAB. That said, despite its increasingly autonomous role, the APB was still technically a committee of the CCAB until 2001 when it came under the umbrella of the Accountancy Foundation (see Figure 5.4, again). However, the point is that RSB/RQB status linked many of the professional institutes to the State, through the FRC, in perhaps a more explicit manner than ever before.

In 2003, the CGAA (*Co-ordinating Group on Audit and Accounting Issues*) was set up by the DTI and the Treasury with the broad task of addressing audit and accounting from the perspective of corporate governance (including the Smiths and Higgs reports), professional ethics, regulation and accountability. The final report of the CGAA was presented in January 2003 and we now know that this led to the revised social structures presented in Figure 5.5, including the APB. At the same time, the DTI's Review Group (2003) on the *Review of the Regulatory Regime of the Accountancy Profession* was set up with the intention of strengthening and simplifying the accounting and auditing framework against a background of changing national and international expectations. Its report was presented at the same time as the report of the CGAA, as explored previously in section 5.1.1.

It is worth selectively summarising some of the issues presented in the CGAA (2003, p9-15) report insofar as these relate to legitimisation, particularly, those social structures that support audit independence and objectivity. The public interest is served by such pursuits because, theoretically, the scope and potential for malpractice is consequently reduced:

- The public interest argument that long standing auditor and management relationships compromise auditor independence resulted in the recommendation to rotate audit partners every five years or less.
- The public interest argument that the fees earned from related non-audit work could compromise the independence of auditors, resulted in the recommendation for audit committees to be established to police the release of this work as well as in respect of other matters. In this regard, audit committees act as ethical watchdogs ensuring that conflicts of interest are minimised.
- The public interest is served by audit firms being alert to, and disclosing, any threat to auditor independence arising from the fear of losing an economically significant client, 'significant' being determined by greater than 5% of the total fee income earned by a firm of auditors.
- The public interest is served by an independent and regular review of the way audit firms manage their independence from clients.
- The CGAA welcomed the move in the EU to adopt international accounting standards of auditing by 2005 – a move towards an internationally based shared value system based on rule creation.

In addition to the above institutional/structural changes, the current regime sees strong formalistic moves towards the streamlining of audit regulations (another social structure), in particular, streamlining according to a common set of rules at the international level

under the auspices of International Assurance and Auditing Standards Board (IAASB).

When coupled with the structural changes raised in section 5.1.1, the response to enforcement, particularly post-Enron, has generally been to regulate. Unsurprisingly therefore, the first duty of an auditor is to report on compliance with the rules and regulations, or not as the case may be, specifically, the Companies Act, though this would also include compliance with accounting and auditing standards.

The second duty of an auditor is to report a “true and fair view”. This obligation is placed upon the ‘professional’ man/woman alone to exercise their professional judgement on such matters (see section 5.2 previously). The point however to be made, and developed further, is that the ‘marriage’ of accounting rule compliance with professional judgement, or in the case of auditors, an opinion, can sometimes be a conflicting one. In other words, there is tension inherent to this aspect of the legitimisation structure. For example, the professional judgement of an accountant to depart from a rule of accounting may or may not be supported by another professional judgement and formal opinion of an auditor, both parties respectively relying on the use or abuse of the true and fair view override (s227(6) Companies Act 1985) as enacted by the State. The natural inclination of both parties is always for accounting rule compliance as well as compliance with the law in whatever manner that may be applied in practice. Yet, whilst this requirement dominates in practice, it is also tempered by professional judgement and a desire to pursue a true and fair view. As Flint (1980, p9) argues, the desire to portray a true and fair view of financial reality can be viewed as a ‘fail-safe’ device where a strict application of the accounting rules would otherwise lead to unrepresentative financial statements. Let us explore the above structural tension further.



Under sections 235 and 237 of the Companies Act 1985, the auditors of a company are required to give an opinion on the financial statements, specifically, whether they comply with the various requirements of the Act and whether they present a true and fair view of the company's financial affairs. This requirement is created by statute, supplemented by accounting rules, and enforced by the Courts. Whilst there is often latitude in the manner in which these laws and rules may be interpreted, nevertheless, in themselves they are, collectively, attempts to achieve consistency and objectivity in the accounting representation of financial reality. Yet, at the same time, it is upon the application of supposedly objective legal and accounting rules that an entirely subjective opinion is formed: that the resultant financial statements present a true and fair view. But is that view formed and enforced against the rules of accounting or against some broader economic based true and fair view of financial reality?

Arden (1993, para 14) comments:

“...true and fair view is a dynamic concept. Thus what is required to show a true and fair view is subject to continual rebirth.”

However, legitimating against a social structure that is subject to “continual rebirth” is also one around which it is difficult to form norms of behaviour, let alone normative rules, because of the abstract nature of the term ‘true and fair’. For example, Knapp (1985, p208) found that in a conflict of opinion between management and auditor on the final form of published statements, resolution was more likely where the issue was not covered precisely in an accounting standard. Under such circumstances auditors were able to justify ‘innovative’ as well as ‘conservative’ reporting decisions, for example, in respect of the innovative capitalisation of brands by some notable companies.

### *Summarising so far*

The first part of the section revealed numerous proposals for changes in the social structures of accounting and auditing as a means of regaining public confidence, post Enron, in the accounting and auditing institutions of society. It is structural change that is being driven by the State in the expectation that this will lead to social action that will minimise the possibility of an Enron-type situation occurring again. But it will only ever be an expectation until recalcitrant actors are held to account for their actions by these bodies. As was shown in the second part of this section, those actions will be judged according to the rules and principles promulgated by these revised bodies such as the APB, as enforced by the FRRP (see Figure 5.5). This is where the efficacy of ‘structural change preventing accounting malpractice’ will actually be tested. In this regard, auditors have the problematic task of legitimating a constructed version of financial reality on the basis of an opinion that various accounting/auditing rules have been complied with. At the same time, that opinion is supposed to legitimate the truth and fairness of that social construction, a negotiated construction that sometimes fall short of that aim, for example, where the transactions basis to the recognition of intangible assets fails to capture internally generated intangible assets within its ambit. Where the constructed version of financial reality cannot be agreed upon then a referral to the FRRP may occur – ‘a second opinion’ so to speak.

#### **5.4.2. Audit compliance: The role of Financial Reporting Review Panel (FRRP)**

The FRRP examines departures from accounting standards brought to its attention by auditors. The FRRP can agree revisions to the accounts but the power to compel change would have to be enforced through the Courts.

The white paper on *Modernizing Company Law* (CM 5553-1) (July 2002) sought to expand the role of a reconstituted FRRP (see Figure 5.5) so that it could proactively enforce for itself the form and content of financial accounting rules rather than seeking enforcement through the courts. These administrative powers would become statutory. It would also be able to address non-financial as well as financial disclosures. Given the overwhelmingly successful enforcement record of the FRRP (to be explored in chapter six) the distinction is perhaps academic but it does nevertheless indicate the government's intention, rather than the profession's intention, to be aggressive in punishing miscreants following scandals such as Enron and WorldCom since this is perceived to be in the public interest.

The FRRP's institutional structure legitimates the profession as a responsible body concerned about enforcing a consistent version of financial reality, one that is compliant with the rules of accounting. Whereas, the consistency of approach for auditors is documented in various guidelines, such guidelines are sparse with regard to the relatively new institution that is the FRRP. However, twenty 'principles' were set out by the FRRP in a letter to the Committee of European Securities Regulators (CESR), a body charged by the European Union (EU) under Recital 16 of the EU Accounting Regulation (the regulation that promulgated the convergence of European practice based on IASB standards from 2005 onwards) to develop a common approach to the enforcement of international accounting standards. Let us consider selected principles from that social structure insofar as they legitimate the existence of the FRRP as well as what it does in practice.

As we shall see from the selective review of the aforementioned principles (letter dated 17/01/03 by the FRRP to CESR – reference abbreviated to FRRP1) the UK regulatory enforcement structures are apparently more developed than their European counterparts – the European enforcement function being performed mainly by national stock exchanges.

A recent positioning of CESR on the issue of enforcement is presented in a *Draft Standard No.2 on Financial Information Coordination of Enforcement Activities* (CESR/03-317b, October 2003 – abbreviated here to CESR2):

- (a) All EU national enforcement bodies, individually, should take into account the decisions taken by other national enforcement bodies so that there can be a degree of consistency and harmonisation in those decisions, collectively.
- (b) A confidential European database is proposed to facilitate point 1.
- (c) To obtain harmonisation, a forum for the regular consideration of decisions and other experiences by national enforcement bodies will be established called the European Enforcers Coordination Sessions (EECS).

These practical moves follow the responses of various national enforcement agencies throughout Europe to an earlier *Proposed Statement of Principles of Enforcement of Accounting Standards in Europe* (CESR/02-188b, October 2002 – abbreviated here to CESR1). The FRRP's response, per FRRP1 above, may be selectively summarised in order to explicate seven points of interest in relation to the issue of legitimation. They are as follows:

(1) "*Irrespective of who carries out enforcement any code of conduct or best practice or procedure established by CESR should be complied with*" (CESR1, p5, underlining added)

By these documented structures CESR hopes to standardise norms of accounting and auditing behaviour throughout Europe. However, as the FRRP point out (FRRP1, p5), the

element of compulsion is missing from such underlined terms because the underlined terms are not enforcement mechanisms:

“It is not usual, for example, to require compliance with a ‘best practice’ statement...The Panel would welcome involvement in the further discussion of these operating procedures and practices” (FRRP1, p5).

Thus, the cycle of social action reinforcing the social structures of enforcement (see Figure 5.2) posed by such codes and procedures would be a voluntary one for the time being. By comparison, the enforcement power of the FRRP, as we shall see when we look at ‘resources’ in cycle two, chapter six, is a formidable yet subtle one under s245b of the Companies Act 1985.

*(2) “Competent administrative authorities shall have adequate independence from government...” (CESR1, p5)*

The FRRP’s response was to point to the independence afforded by its diverse funding arrangements between the accountancy bodies, the Stock Exchange, other City institutions and the DTI. In addition (FRRP1, p5):

“The Panel safeguards its independence by maintaining a fund of some 3 million euros which it could use to pursue companies to Court if an element of funding was withdrawn.”

However, what was not mentioned was the delicate balance of powers between the State and the accountancy profession, as presented in section 5.1.1, in response to repeated corporate failures. For example, the Secretary of State for Trade and Industry commented on the existing structures of enforcement in the following proactive, and far from independent, terms (carried into effect in 2004):

“We will also strengthen the enforcement of accounting standards. At the moment, the financial reporting review panel steps in only if particular concerns are raised with it... From now on, the Financial Services Authority will help the financial reporting review panel on enforcement – especially by identifying the high-risk cases that most merit investigation. The FSA and the panel will need to agree as soon as possible a

memorandum of understanding to clarify their precise roles and responsibilities” (Ms Hewitt, 29/01/03, column 881, The United Kingdom Parliament).

The clear implication is that the existing reactive, quasi-judicial role of the FRRP would change to one that would be more proactive in terms of its investigative powers. CESR had the same thoughts:

*(3) “Enforcement of all financial information is normally based on a selection of companies and documents to be examined. The preferred models for selecting financial information for enforcement purposes are the mixed models whereby a risk based approach is combined with a rotation and/or sampling approach” (CESR1, p7).*

In response, the FRRP states that it is currently a reactive body, rather than a proactive one (FRRP1, p9) but it also acknowledges that this would change in the immediate future (now carried into effect in 2004):

“The Panel is presently considering a number of options but aims to be proactive from early 2003, in respect of the 2,500 listed companies or so that are currently within its scope” (FRRP1, p10).

However, the FRRP sees little point in being tied to any mix of models since this may, for example, “preclude bona fide complaints being put to it by third parties”, that is, it may discourage a vital source of information that is provided by “whistle-blowers” (FRRP1, p10).

*(4) “The necessary powers...should at least include power to monitor financial information, require supplementary information from companies and auditors, and take measures consistent with the purposes of enforcement” (CESR1, p5).*

The FRRP objection to this principle (FRRP1, p6) was important in that it legitimated the FRRP as an independent and reactive (not proactive) quasi-judicial body. Thus, it may be argued that we are starting to see the structural strains of an attempt to legitimate two disparate stances at the same time: “to be proactive” (and therefore less independent) and,

at the same time, reactive (and therefore more independent). How, for example, can the FRRP be seen to be proactive where...

“The Panel does not therefore agree, as a matter of principle, that the competent authority [itself] should have the power to require any information, supplementary or otherwise, from auditors” (FRRP1, p6, brackets added).

Equally, if CESR’s proposed powers were carried into effect at the national level, the act of “monitoring of financial information” could jeopardise the independence of the FRRP, or similar European body, by supplanting what is rightly a managerial function. Perhaps, this is an unavoidable consequence of being proactive? Also, requiring “supplementary information” from auditors could jeopardise their independence and their contracts of engagement by supplanting one master with two: the enforcement body as well as shareholders, with potentially disparate and conflicting interests:

“...auditors plan, conduct and evaluate the results of their work in order to support an audit opinion which is addressed to shareholders, not in anticipation of satisfying financial regulators on unspecified issues. Their work may not be of a nature or in a form that would be helpful to a regulator. This, of itself, could unfairly prejudice an investigation and the auditor’s part in the production of the audited accounts, an assessment of which is outside the scope of the administrative authority” (FRRP1, p6).

The independent quasi-judicial role of the FRRP as ‘rule enforcer’ was highlighted by the following principle:

*(5) “For financial information...ex-post enforcement is the normal procedure, even if pre-clearance is not precluded” (CESR1, p7).*

Whilst concurring with the concept of ex-post enforcement the FRRP was, nevertheless, opposed to the pre-clearance of accounting techniques for a number of reasons (see FRRP1, para47, p9) but the overriding concern was that of maintaining its independence as a responsible body:

“...the ‘clearance’ of accounting treatments and presentations pre-publication would lead the Regulator to assume the risks and duplicate the responsibilities of directors and auditors” (FRRP1, p9).

*(6) “Where a material misstatement in the financial information is detected enforcers should take appropriate actions to achieve an appropriate disclosure and where relevant, correction of misstatement (in line with the requirements of the reporting framework...”(CESR1, p8).*

The FRRP urged the CESR to adopt the IASB definition of what is meant by ‘material’ and the UK’s position of allowing directors to withdraw defective accounts and replacing them with ones of which the FRRP approves as being compliant with accounting standards. They argue that this action:

“...is one that the Panel would suggest that other member states may want to consider implementing. It is a means of ensuring that filed financial information complies with the relevant accounting requirements. By improving the reliability and integrity of the financial statements the action also serves to improve the confidence with which they are read by users” (FRRP1, p11).

Also,

“The UK however would not want to lose the ability to apply this action [rectification] simply on account that other legislative frameworks do not provide for it” (FRRP1, p12, bracket added).

The ‘after-the-event’ capability to rectify accounts is an important enforcement mechanism. It invites the directors to ‘do the right thing’ and, at the same legitimates the authority of the FRRP as a responsible body that acts in the public interest without the need to use force. Thus, rectification avoids the use of allocative and authoritative resources to compel change – to be addressed in chapter six, next.

*(7) “Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation because: actions are measures generally aimed at improving market confidence and integrity; sanctions are mainly aimed at punishing the infringer” (CESR1, p8).*

In response,



“The Panel supports a clear distinction between actions and sanctions as, in some jurisdictions, sanctions are applied by regulatory authorities other than the administrative authority or its ‘Panel’ delegate” (FRRP1, p12).

The term ‘sanction’ is used by these bodies in its restrictive sense (the power to punish) whereas sanctions may be permissive as well as prohibitive – see Figure 5.2. The issue here is enforcing change according to the behavioural norms of the profession (not punishing it), through FRRP rulings, publicity, the invitation to rectify accounts and so on. But the aim is common: to “improve market confidence and integrity” as supported compliant accounting practice according to the rules of accounting.

#### *Summarising this subsection*

The general thrust of developments has been to formalise audit compliance through audit rules and the above principles alike. Like CESR, the response of the State has been to use the power it has to effect change to social structures with the focus on better rules of enforcement as well as institutional change. This is the *de jure* stance of an auditing profession intent on enforcing a true and fair view of financial reality if necessary by referral to the FRRP. However, *de facto*, better rules of enforcement often lead to better ways to circumvent them – essentially an issue of power. However, this does dissuade the State from structural change perhaps, because it needs to be seen to be doing something in respect of corporate collapses even if that something subsequently turns out to be ineffectual.

### **5.5 Summary outcomes**

An outcome arising from section 5.1 is the failure of the profession to respond to a societal need to prevent financial fraud and accounting malpractice occurring in practice. The appropriate social response has been to expose such instances, examine them and to learn

from them. Thus, there has been a trade-off over the years in terms of the privacy of investor information and the general move towards greater public disclosure driven by “public interest” arguments. The supporting argument is that greater disclosure means greater transparency and therefore less scope for fraud and malpractice. Second, where an autonomous professional group is unable or incapable of responding to the above societal concern then it is incumbent on the State to interdict, particularly where related corporate collapses receive considerable press attention. However, interdiction typically takes the form of statute and there is no basis to suggest that this approach would be any more successful in preventing fraud and malpractice than that undertaken previously within the existing regulatory structures of accounting. Nevertheless, the State has to be seen to be doing something and therefore, in concert with the professions, it has sought structural change, such as the imposition of the FRC and its related social structures.

In section 5.1.2 the institutionally-led process of consultation in the creation of accounting standards was explored. Just as a piece of legislation undergoes a process of consultation (green paper, white paper, first reading, committee stage and so on) so an equivalent social structure has been created around the accountants’ regulatory process. The intention is provide a coherent frame of reference for discussion of the views of the collectivity in the formation of accounting standards. The resultant social structure is legitimised if, as a consequence of consultation, a consensus is reached on the content and structure of an accounting standard. Where a consensus is not obtained then power has been exercised by the Board to direct the content and structure of an accounting standard. As we saw in respect of Figure 5.6 sometimes the resultant accounting standard also arises from a compromise between the Board’s view and the views of respondents to the consultation process.

In both cases, 5.1.1 and 5.1.2 above, the aim has been to create or change social structures, institutionally and in terms of what they regulate (Box A point 1), that arise from processes of consultation. By being consultative and in responding to societal concerns about accounting malpractice, particularly post Enron, the profession seeks to show that it is a morally responsible entity that is still geared towards serving the public interest (Box B point 1). The implicit and, perhaps, false assumption is that by seeking structural change, institutionally and regulatory, there will somehow be a reduction in the nefarious actions of certain members of society is probably unrealistic. Nevertheless, the general response has been to further regulate on what constitutes permissible or prohibited behaviour (Box C point 1). Where social action subsequently supports these social structures then a positively reinforcing cycle exists and the outcome (Box D) is that there is societal support for the accounting construction of financial reality. That is the *de jure* position; the *de facto* reality may turn out to be somewhat different – to be explored in chapter six.

Turning now to the second normative rule related to professional conduct, consultation is insufficient by itself to legitimate a social structure and any related social action as being in the public interest. For example, politicians consult using the media (a social structure) but their actions are not always perceived to be in the public interest. The integrity of those social actors doing the consulting also matters, in the case of accountants, that they are morally obligated to act ‘professionally’ (Box B point 2). It is therefore incumbent upon the accounting profession (of which the ASB is a part) to ensure that, as far as possible, those who practice accounting are morally responsible persons. The social structures in this regard comprise an institutionally-based professional education and training as a means of filtering out unsuitable candidates (Box A point 2). Once suitable candidates are

invited into membership of the collectivity they are obliged to conduct themselves according to another social structure: codes of behaviour (again Box A point 2). A further social structure (again, Box A point 2) is created: disciplinary panels and processes for those members who do not act morally according to the norms of behaviour of the collectivity. In such cases sanctions will be applied: the disciplining of recalcitrant members of the collectivity (Box B point 2).

The social action in respect of the professional man/woman has broadened considerably over the years to include many financially based functions outside the original remit of insolvency and audit work. However, regardless of the context, the outcome is that in presenting their figures for public scrutiny they have been prepared by professionals who are able to accurately portray a true and fair view of business reality (Box D). The *de jure* stance is that the professional man/woman acts in the public interest because they act morally, both personally and professionally, according to the codes and rules of accounting. The *de facto* reality, particularly with regard to the efficacy of disciplinary hearings, may be somewhat different but it is, nevertheless, against the above *de jure* stance that the profession seeks to legitimate its position in society.

In relation to the third normative rule, legitimating ones position in society against a rational conceptual schema (Box A point 3) is undertaken so that, first, a conceptual foundation can provide for consistency in the construction of standards and in actual practice and thereby avoid conflicts between them. Second, conceptual schema can provide direction on those matters not covered by standards of practice. This can be useful from an audit viewpoint, particularly where the presentation of a true and fair view has an element of negotiation about it, that is, between auditor and management. Finally,

conceptual schema can provide for the future direction of standard setting, which is increasingly directed towards an economic focus to accounting in general. Rationalising accounting practice against such benchmarks shows that the profession is an intellectually based discipline in its own right (Box B point 3) – an intellectual legitimacy that obligates social actors to adopt it and rationalise their practices against it. That discipline is applied with the intended outcome (Box D, Figure 5.1) that a true and fair view of financial reality will be constructed thereby. However, the social construction of financial reality is inherently subjective in nature for the reasons outlined in section 5.3. As such, ‘truth and fairness’ is a matter of opinion (Box B point 3) and in this regard perhaps the stronger influence is compliance with the rules of accounting. This does not matter because, if the *de jure* stance outlined above is operating correctly, then the rules, such as FRS10, and the principles presented in a conceptual framework would compliment each other. However, the *de facto* reality often turns out to be somewhat different.

The *de facto* reality, for example, is highlighted by the conceptually eclectic nature of an asset definition that respectively comprises economic and legal perspectives and two time frames: future economic benefits and past transactions. Also, the paradox associated with the fact that a supposedly objective conceptual framework (social structure) cannot avoid subjective policy choices (social action) in its construction, the use of definitions being one such choice. Tracing, for example, the historical development of conceptual frameworks in respect of measurement bases in section 5.3 underscored this paradox.

The outcome from section 5.4 previously, that is, the cycle of “Box A point 4 linked to Box B point 4 linked to Box C point 4” in Figure 5.2 is summarised last of all.

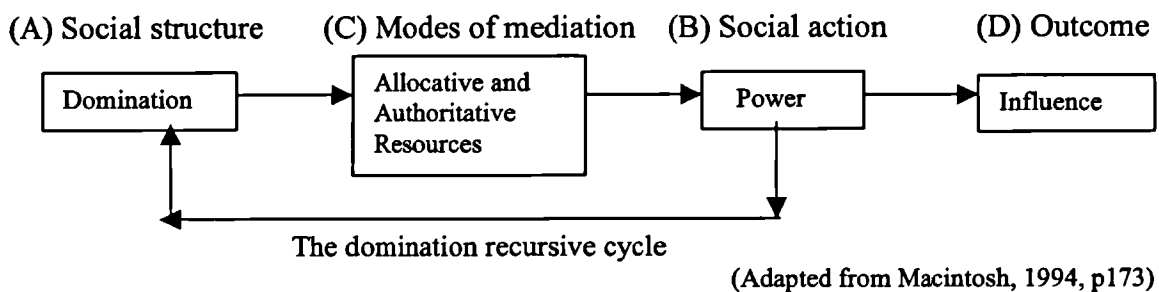
Finally, in relation to the fourth normative rule, as the conduct of society is regulated by laws, so too is the policing of those laws subject to rules, for example, concerning the collection, presentation, examination and cross examination of evidence. The aim is to sanction recalcitrant members of society where the norms of behaviour have been broken because without sanctions the social structures of society may begin to break down, causing anarchy. In the same way the APB provides and to some extent polices the rules of investigation surrounding the audit function (a social structure intended to guide social action). As we saw from the CGAA report and Figure 5.5, those structures (Box A point 4) have been subject to amendment to reinforce their independence and objectivity. A referral to the FRRP (another institutional structure - Box A) can occur where an audit opinion on an accounting practice is not accepted by management. It too has been subject to structural change as its role changes to a proactive one. The FRRP are concerned with enforcing the 'correct' version of financial reality according the rules and principles of accounting and auditing (the outcome: Box D, Figure 5.1). There is a moral obligation placed upon the profession, the APB and the FRRP in particular, to ensure that the version of financial reality to be presented to society is a consistent one that is comparable with other versions of it created for other entities in society (Box B point 4). Otherwise, the picture that accountants seek to legitimate as 'true and fair' may become suspect. To ensure that this cycle of events occurs sanctions may be applied by the FRRP to enforce the accountants' representation of financial reality (Box C point 4). It is at this point that we come 'full circle' in linking back to section 5.1.1. The Board may regulate for a social construction of financial reality but without the structures to enforce it in practice that construction may be seriously undermined by fraud, malpractice and legitimate circumvention within the existing rules. We shall examine some examples in this latter regard when we look at Domination in the next chapter.

## Chapter six – Domination

### 6.0. Introduction

Giddens (1979, p53) argues, “action and structure presuppose one another”. In some cases, social action leads to a modified social structure and vice versa, and in other cases, action may simply reinforce the existing social structure and vice versa. The recursive process where “structure is both medium and outcome of the reproduction of practices” is what, to repeat, Giddens (1979, p5) referred to as “duality of structure”. This recursive process or cycle at the level of domination is evident in Figure 6.1, that is, in the link between social structure (Box A) and social action (Box B).

**Figure 6.1: The process of domination**



Repeated references to ‘Boxes’, in this chapter alone, refer to the content of Figure 6.1.

At the level of domination, social structures, here, comprise institutionally dominant coalitions of knowledge and practical accounting skills (Box A) that coalesce around the application of accounting rules and principles. Within a coalition, power often flows in subtle ways, and not necessarily hierarchically, such that its effects may go unnoticed in the social conduct of accountants (Box B). At other times the effects of power are prominent and relatively transparent, for example, as when the accountants of a listed company have to answer to the FRRP for their accounting practices. Under such

circumstances, power works to constrain the action of accountants and companies but it is also important to comprehend that power can also be applied as an emancipatory tool. The use of power in directing the conduct of social actors (and things) requires resources (Box C), for example, the financing of physical labour (an allocative resource) and the expertise of labour (an authoritative resource). Without resources the social structures would become ineffectual in determining social action and vice versa. Thus, the three boxes in Figure 6.1 (Boxes A, B, C) are linked in a recursive manner that typically reinforces social structure but not in every case. Out of this process, whether reinforcing or not, comes ‘outcomes’ (Figure 6.1, Box D).

Let us now explore these boxes in relation to goodwill and intangible assets. It is the power of the Board to construct and enforce their social construction of financial reality for would-be users of financial statements that is pertinent here. There are, respectively, two recursive cycles in that regard: first, the power of the Board to construct accounting rules and principles which guide that social construction (cycle one in section 6.1) and, second, the power to enforce compliance with those same rules with the aim of portraying a consistently true and fair view of financial reality (cycle two in section 6.2).

In respect of cycle one, the allocative and authoritative resources of the Board (Box C) were directed towards various consultation processes in the construction of the FRS10 accounting standard. Power (Box B) was exercised to that end and to direct the form of the resultant social construction – FRS10. A dominant coalition (Box A) was built around the notion of purchased goodwill being an asset, at least for disclosure purposes. A supporting coalition was drawn from an international consensus to that effect to support a definition of an asset that was sufficiently broad to allow a wide degree of discretion as to what



would or would not count as an intangible asset for accounting purposes. This cycle of social structure supporting social action, or not as the case may be, occurred recursively for each stage of the consultation process (discussion paper, working paper, exposure draft, etc.) and, at each stage, power was exercised to progressively narrow down the debate in order to create the FRS10 accounting standard. Where a dominant coalition was formed on the basis of a consensus then the recursive cycle one was a positively reinforcing one. Where power was exercised to override a consensus then the cycle was a negatively reinforcing one - one based on the power to direct the outcome of a consultation process (to be addressed in cycle two). As Macintosh (1994, p175) states:

“Domination concerns a social system’s capacity to achieve outcomes, to produce power.”

In addition, cycle one was linked to another recursive cycle (cycle two) to be explored in section 6.2. In cycle two, allocative and authoritative resources (Box C) were again mobilised to ensure practical compliance with the social construction arising from cycle one. A dominant coalition was built around the notion of establishing a ‘true and fair view’, one that, in the main, was based on full compliance in practice with the rules and principles of accounting - a social action that positively reinforced the social structure. However, full compliance in practice may be circumvented legitimately (examples are presented in section 6.2.1), or, indeed, illegitimately. In this latter case, the social structures of enforcement come into play, as outlined in section 5.4.2, to ensure compliant social action (Box B), willingly or otherwise, towards the ‘correct’ version of financial reality – principally, the FRRP’s version of truth and fairness (Box A). In most cases though, cycle two operates passively and recursively within each successive accounting period, as practical compliance (Box B) supports the accounting portrayal of truth and fairness in the financial statements (Box A). The two cycles are presented sequentially (section 6.1 and 6.2) since this reflects the order in which they are executed in practice.

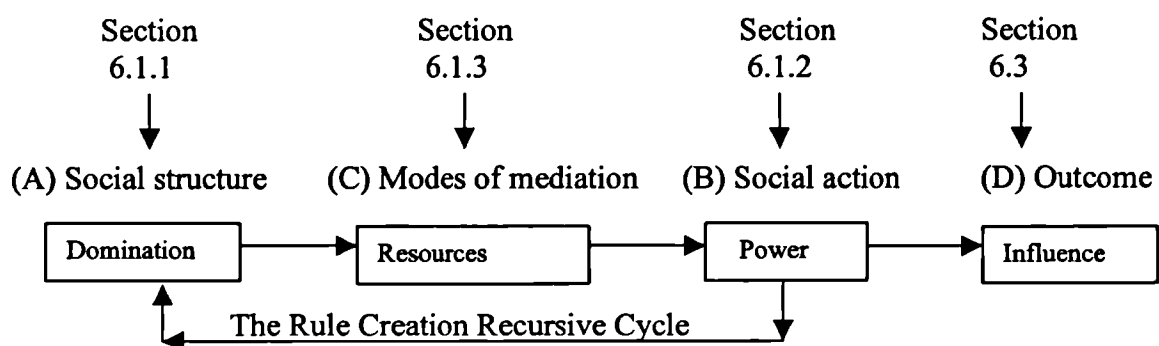
The data set supporting the explication of cycle one are the various consultation papers leading up to the implementation of FRS10 (1993-1997). The data sets supporting the explication of cycle two are the various consultation papers leading up to the implementation of FRS10 (1993-1997), the results of a longitudinal survey of goodwill and intangible asset accounting practices (1993-2002) (the longer period is undertaken to include post FRS10 (1997) effects) and the selective use of FRRP's press notices since its inception.

Section 6.3 presents the outcomes (see Figure 6.1) from the recursive cycles one and two together with a summary.

### 6.1. Cycle one: The Board's dominance in rule creation

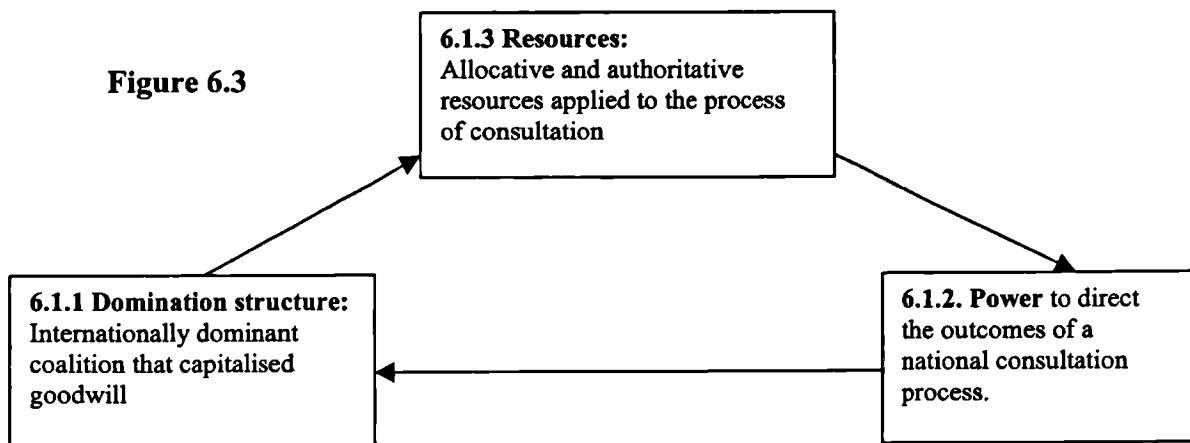
In respect of cycle one, the recursive elements of social structure, social action and resources are addressed sequentially in three subsections: 6.1.1 to 6.1.3. These are depicted in Figure 6.2

**Figure 6.2: The process of domination (cycle one)**



(Adapted from Macintosh, 1994, p173)

The three recursive elements of Figure 6.2 may be summarised diagrammatically as in Figure 6.3:



The implication of the recursive cycle presented in Figure 6.3 is that whilst the Board sought to legitimate rule creation by a national process of consultation (section 5.1.2) it uses the power it possesses to steer the process of that national consultation towards internationally dominant structures, ones that advance the asset status and impairment review of purchased goodwill. The outcomes from this recursive cycle one (Figure 6.2, Box D) are to be presented together with the outcomes from recursive cycle two (Figure 6.4, Box D), in section 6.3, as a way of summarising the issue of domination.

#### **6.1.1. Cycle one: The domination structure of rule creation**

The dominance of an accounting version of financial reality in society is brought about by attempts at building a dominant coalition and dominant rationale in support of it. Fincham (1992, p751) argued that:

“The dominant coalition itself relates to structures of...power through dominant forms of organizational knowledge. The idea of a dominant rationale, representing a belief system articulated around definite interests, is useful here...These ruling organizational beliefs reflect a contested consensus centred on generalized rules and goals.”

The consensus obtained from the consultation on, and subsequent construction of, national accounting standards or “generalized rules” would, *de jure*, be one such *dominant coalition* (see section 5.1.2 previously). *Dominant rationales*, in this context, are formed when accounting standards are grounded on a common “belief system”. This belief system may be formalised, as with the *Statement of Principles* (section 5.3, previously), or it may coalesce around custom and practice over time. This represents the *de jure* stance that would not only legitimate the cycle of rule creation, cycle one, but see it dominate in practice. The *de facto* reality turned out to be somewhat different: the dominant national coalition in respect of the construction of FRS10 was, to repeat, mainly being driven by international accounting standards development irrespective of the outcomes of a national consultation process.

A concern was expressed by the Chairman of the FRC in his annual report 2002, paragraph 41 ([www.FRC.co.uk](http://www.FRC.co.uk)) with regard to the shift in the balance of power between national and international accounting standard setters:

“If the ASB is to do a good job in representing the UK constituency and furthering its interests, it needs to keep in close touch with the many strands of opinion in the UK that have a contribution to make to the standard-setting process. In order to retain its international respect and continue to exert influence, the ASB needs to retain its capacity to develop its own thinking on the many difficult, complex and novel issues which business developments keep on posing to the accounting experts. Without such a base, it is inevitable that it would merely follow, and never lead, international opinion.”

An implication is that the Board may eventually abandon or change formal processes of consultation at the national level since this process is to some extent being duplicated at the international level [2]. One of the advantages that an internationally dominant coalition has over a nationally dominant one is that accounting practice and the increasingly global business it purports to represent, can be conducted on ‘a level playing field’. For example, historically, one of the most significant differences that affected bottom line reported profit

differentials between UK and US companies was, respectively, the SSAP22 (ASC, 1989b) write-off approach to purchased goodwill and the APB16/17 (FASB, 1970a,b) amortisation approach to purchased goodwill. In contrast, the international moves toward the adoption of the purchase method and impairment reviews only (centred upon the efforts of the IASB in its “Business Combinations” joint project with the FASB (phases one and two, 2003) and now in IFRS3 – March 2004), suggests a shift of power away from the national regulatory bodies to the IASB, particularly as FRS10 will undoubtedly be revised to exclude the alternative approach of systematic amortisation of goodwill (see [www.asb.org.uk/publications/publication project.cfm?upid=52](http://www.asb.org.uk/publications/publication%20project.cfm?upid=52) on Business Combinations). It may be argued that the existence of FRS11 on the *Impairment of Fixed Assets and Goodwill* (ASB, 1998), post-FRS10, and the general convergence on IASB standards (culminating in the Norwalk convergence agreement between the IASB and the FASB – [www.iasb.org.uk/cmt/0001.asp?s](http://www.iasb.org.uk/cmt/0001.asp?s) 15/12/03) are precursors of such a move. That said, there is also an element of ‘follow my leader’ in these developments in that the US had already moved wholeheartedly in the direction of impairment, for example, in FAS121 (FASB, 1995), FAS141 (FASB, 2001a) and FAS142 (FASB, 2001b). The point is that the dominant coalition in respect of goodwill and intangible appears, in large measure, to have

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[2] There is a danger here in that any shift in institutional power from the ASB to the IASB without an accompanying shift in equivalent representation offers the potential for conflict between social structures at the national and international standard setting level. For example, of the 133 responses to the IASB’s exposure draft ED3 on *Business Combinations* (November 2003) there were only 23 UK identified responses (10 from companies, 11 from professional institutes and associations and 2 from private individuals). One may surmise that whilst consultation took place, the low level of UK representation makes it difficult to determine whether the UK national collectivity was (and will be) ‘on board’ in supporting this regulatory change. The counter-argument is that by perpetuating a national consultation process and then funnelling those comments in a summarised form through the ASB to the IASB, adequate representation is still maintained: “We aim to ensure that both our pronouncements and those of the IASB respond in a balanced way to constituents legitimate concerns” (ASB Chairman’s Report, 2003 – see [www.asb.co.uk/about/asbreport.cfm](http://www.asb.co.uk/about/asbreport.cfm), paragraph 6).

been built around international developments, rather than national opinion, notably around FASB and IASB accounting standards development. Thus, whilst the Board sought to legitimate its construction of financial reality against a coalition formed from a national consultation process (section 5.1.2), the dominant structure appears to have been mostly internationally based.

It may be argued that, in asserting the dominance of international developments in the UK regulatory process surrounding goodwill and intangible assets, attention has simply shifted from one arena to another arena without any real ‘cause and effect’ being established between the two arenas. Consider though, the selected comments of the respondents to the national consultation process leading up to FRS10 on this international influence. These comments suggest that, historically, the changes in goodwill accounting policies were being driven:

First, by a desire to harmonise international practice, notably with US practices:

“...the basis for the IASC standard was an American standard which even predated the Financial Accounting Standards Board in about 1970 and it was at a time when goodwill in the United States was about one per cent of net assets.” (David Tweedie, ASB, 1995x, p3)

Second, by negotiation and compromise:

“...a closer analysis of international experience suggests that any argument based on the need to harmonise accounting standards is hollow. Goodwill capitalisation and amortisation originated principally in the USA. US practice was the result of a compromise struck between the regulators and the business community in 1970 and was against the advice of the accounting profession of that time. Rather than follow, we should endeavour to move standard-setters to a more sustainable approach” (Arthur Andersen, ASB, 1994a, p29&32)

Third, by possible State intervention, specifically in relation to goodwill:

“...the international [goodwill accounting] practice is driven by the US practice. The US practice is driven by a critical compromise when Governments threaten to intervene to

prevent an accounting standard which required an immediate write-off of goodwill. This idea that the rest of the world has really cracked this thing, and got a conceptually sound answer is based on a misconception as to how the US standard actually arrived on the scene.” (Nunn, ASB, 1995z, p43, brackets added)

and, more generally:

““Accounting standards are too important to be left to accountants.” This statement, made a few years ago by a member of Congress, reflects the increasing interest of politicians in the work of the Financial Accounting Standards Board (FASB). Congressional hearings during the first half of 2000 provide interesting insights into the influence of the political process on private sector accounting standard setting.” (Beresford, 2001, p73)

It may be reasonably argued that the idea of government and business self-interest guiding the construction of a US accounting standard (the real power behind the power to regulate so to speak) and then that development forming the basis a dominant coalition internationally, is a problematic basis on which to construct financial reality. Nevertheless, it is a valid domination structure, the supporting dominant rationale being a desire to belong to the same international association as everyone else. The ASB’s contribution to this ‘international association’ is a voluntary one that has been given fresh impetus because of the EU convergence deadline of 2005:

“With this deadline fast approaching, the work of the Accounting Standards Board has in 2003 focused particularly on the international agenda. We have continued to work directly with the IASB and have sought to influence its projects to improve and extend existing international standards [including goodwill].” ((ASB Chairman’s Report, 2003 – see [www.asb.co.uk/about/asbreport.cfm](http://www.asb.co.uk/about/asbreport.cfm), paragraph 3, brackets added).

One can see that there are influential links between the various standard-setting bodies in their desire for convergence, both historically and currently.

### *Summarising so far*

The *de jure* stance, explored in chapter five, invites national consultation and consensus building with a view to constructing an accounting standard that is complimentary to a conceptual framework. The purpose is to construct a dominant coalition in respect of a

particular accounting practice and, at the same time, for that practice to be grounded on a dominant rationale that affects all standards and binds them to an integrated and cohesive view of financial reality as accountants see it. The *de facto* stance, presented above, argues that this viewpoint is inherently subjective because the dominant rationale in respect of goodwill appears to have been a desire to adopt international norms of behaviour, norms based in part on politically motivated policy choices. Thus, it would appear that the goodwill rule change from 'no impairment reviews', pre FRS10, to the inclusion of impairment reviews, post FRS10, was undertaken as a matter of preference for international norms of behaviour, in particular, US developments. Thus, the goodwill rule change from non-asset status, pre FRS10, to asset status, post FRS10, was again undertaken as a matter of preference for international norms of behaviour, otherwise, there would be nothing to impair. Also, as we saw in respect of signification, this latter preference at the conceptual level of enquiry was accommodated by a broad definition of an asset that effectively played little or no part in justifying the above switch in asset status. It therefore matters how this power to direct rule creation was exercised because the *de jure* stance in support of a conceptual framework may simply be a smokescreen that legitimates in theory but does not necessarily dominate in practice. Let us address the power to direct rule creation at the national level of consultation as influenced by international norms.

### **6.1.2 Cycle one: The power to direct rule creation – a social action**

According to Macintosh and Scapens (1990, p461):

“Agency and power are related in that agency entails the ability to act otherwise, to be able to intervene in the world, or to refrain from intervening.”

In the goodwill and intangible asset context of this thesis, social action typically occurs within the rules of accounting, that is, supporting, complying and reinforcing the related



social structure. That said, the existential freedom of social actors comprehends the right to do otherwise, for example, to manipulate the accounting rules, as with brand capitalisations or to form other coalitions, such as the accounting professions' links with the DTI in undertaking structural changes to the regulatory and supervisory bodies of accounting (see section 5.1.1). Thus, power in an agency sense would reject the notion of any group being privileged as, for example, might be perceived in a superior to subordinate relationship. There may indeed be a 'superior and subordinate' process at play but the subordinate is able to influence the exercise of power by the superior through the dialectic of control:

"By the dialectic of control I mean the capability of the weak...to turn their weakness back against the powerful" (Giddens, 1982, p39).

The dialectic of control assumes a two-way use of power and that sometimes the subordinates can be the cause of radical change in social structures, including institutional ones (ASC to the ASB in 1990? – see Singleton-Green (1990)). Equally, in respect of the regulatory structures of accounting, it is rare to find cases where the subordinates (the accounting collectivity) were able, after the event, to overturn the social construction (accounting standards) formulated by the superior (the Board) but the inflation accounting debacle of the early 1980s and the removal of SSAP16 was one such instance – to be explored in section 6.2.3.

The exercise of power is never static even for relatively long-lived attributes of power such as those associated with expertise and authority. The need to study power politics as they emerge means that the time/space context is vital to an understanding of them:

"The problem with order in social theory is how **form** occurs in social relations, or...how social systems 'bind' time and space. All social activity is formed in three conjoined moments of differences: temporally, structurally...and spatially: the conjunction of these express the **situated** character of social practices. The 'binding' of time and space in social

systems **always** has to be examined historically, in terms of the bounded knowledgeability of human action.” (emphasis as per original, Giddens, 1981, p30)

Today’s power relations are often a legacy of the past. For example, the **form** of FRS10 allowed two methods to occur, capitalise/amortise and capitalise/impair, that was **situated** in a specific time and space, in the UK from 1993-1997 onwards, and which added to the social structure of accounting. It arose from an extensive historical debate that has now bound accounting actions to capitalisation methods rather than to write-off methods of accounting.

Power may often be viewed in a negative, restricting, enforcing sense, a way sometimes of preventing the emergence of truth. However, Giddens (1984, p257) would disagree:

“Power is not, as such, an obstacle to freedom or emancipation but is their very medium – although it would be foolish, of course, to ignore its constraining properties.”

A fully documented consultation process leading up to the implementation of an accounting standard is very unlikely to prevent the emergence of truth because the purpose of it is to encourage debate, albeit in a structured way. Nevertheless, it is the constraining properties of that process that are of interest here: where “truth” is ignored or selectively overridden in order to affect structural changes sometimes contrary to the wishes of the majority of the collectivity. According to Fincham (1992, p752, brackets added), this is not surprising because the:

“Means of selection serve to reproduce dominant forms of knowledge. Certain types of organizational control are embedded in interaction, but selection represents a much more explicit instrument of the reproduction of power. Selection represents the formalization of the patronage powers of senior incumbents [in this case, the Board], crucially legitimised by bureaucratic rules of rationality.”

As we shall see when we look at the consultation process leading up to the implementation of FRS10, the Board exercised a “means of selection” that narrowed accounting options at

every stage of the process and in some cases this did not result in “dominant forms of knowledge” if the term dominant refers to a majority viewpoint on an issue. Indeed, the process of selecting and rapidly narrowing accounting options was an “explicit instrument of the reproduction of power” of the Board, used to achieve specific effects, notably, compliance with the international norms of goodwill capitalisation and the trend towards impairment reviews – the domination structure.

The analysis is presented chronologically, as per section 2.7, starting with the discussion paper (ASB, 1993). The discussion paper presented (ASB, 1993, p6/7) six possible accounting methods - repeated in Table 6.1 for the sake of clarity:

**Table 6.1 The accounting methods presented in the discussion paper**

Method A: “Purchased goodwill is capitalised, then amortised over a predetermined finite life subject to a maximum of, for instance, 20 years. The amortised carrying value is assessed each year for recoverability” (ASB, 1993, p6)

Method B: “Purchased goodwill is capitalised, then amortised through the application of systematic annual review procedures to estimate the required annual amortisation charges. There may be years when the annual amortisation charge is zero” (ASB, 1993, p6).

Method C: A combination of columns A and B methods. Column A would be the method used for most acquisitions, but method B should be used in those special circumstances where the goodwill has an indeterminate life expected to be greater than 20 years (see ASB, 1993, p6).

Method D: “Purchased goodwill is eliminated against reserves immediately on acquisition” (ASB, 1993, p7).

Method E: “Purchased goodwill is transferred to a separate goodwill write-off reserve immediately on acquisition” (ASB, 1993, p7).

Method F: “Purchased goodwill is transferred to a separate goodwill write-off reserve immediately on acquisition and the balance in this reserve is assessed for recoverability at each year-end. Losses reducing the recoverable amount below the balance in the write-off reserve are charged to the profit and loss account” (ASB, 1993, p7).

The actual responses to these accounting choices are presented below in Table 6.2, columns A-F. In addition, column G assesses the degree of support (Y), or not (N), for the separable disclosure of intangibles, rather than their subsumption within purchased

goodwill as initially proposed in the working paper. Finally, column H assesses the degree of support (Y), qualified support (QS), or not (N), for the “ceiling tests” (impairment review) presented in the discussion paper (ASB, 1993, p50-64).

<b>Table 6.2</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>G</b>	<b>H</b>
<b>Respondent</b>	<b>Cap &amp; amort</b>	<b>Impair review Only</b>	<b>Com- bo A&amp;B</b>	<b>Imme- diate W/o</b>	<b>Sep. W-off Res.</b>	<b>Res. Rec- orv</b>	<b>Sep Intan</b>	<b>Ceil- ing Test</b>
Allied Lyons Plc					1 <sup>st</sup>		Y	N
American Appraisal Ltd		2 <sup>nd</sup>	1 <sup>st</sup>				Y	QS
Archer S			1 <sup>st</sup>				Y	QS
Armitage RL	nc	nc	nc	nc	nc	nc	nc	nc
Arthur Andersen & Co					1 <sup>st</sup>		Y	N
Assoc. of British Insurers		=1 <sup>st</sup>				=1 <sup>st</sup>	Y	QS
BAT Industries	1 <sup>st</sup>						Y	N
BDO Binder Hamlyn	1 <sup>st</sup>						Y	N
BOC Group Plc		1 <sup>st</sup>					nc	nc
Boots Plc		1 <sup>st</sup>					N	Y
Bristol Business School	2 <sup>nd</sup>				1 <sup>st</sup>		Y	N
British Bankers Assoc.				2 <sup>nd</sup>	1 <sup>st</sup>		Y	N
British Gas Plc	1 <sup>st</sup>						Y	N
British Merchant Banking...					1 <sup>st</sup>		Y	N
British Petroleum Plc	1 <sup>st</sup>						Y	N
British Telecomm. Plc					1 <sup>st</sup>		Y	N
Budworth DW	nc	nc	nc	nc	nc	nc	nc	nc
Cable & Wireless Plc					1 <sup>st</sup>		Y	N
Cadbury Schweppes Plc		2 <sup>nd</sup>			1 <sup>st</sup>		Y	N
Central Statistics Office	1 <sup>st</sup>						nc	nc
Certified Accountants	1 <sup>st</sup>		2 <sup>nd</sup>				Y	N
Management Accountants	1 <sup>st</sup>						Y	N
Public Finance & Acc.					1 <sup>st</sup>		N	N
Coats Viyella Plc					1 <sup>st</sup>		Y	N
CBI	=1 <sup>st</sup>			=1 <sup>st</sup>			Y	N
Coopers & Lybrand			1 <sup>st</sup>				Y	N
Damant D		1 <sup>st</sup>					QS	nc
Davies MJ & PH	1 <sup>st</sup>		2 <sup>nd</sup>				Y	N
Ernst & Young	1 <sup>st</sup>						Y	N
Financial Executives Group	nc	nc	nc	nc	nc	nc	Y	nc
Fryer G				1 <sup>st</sup>			Y	N
Glaxo Holdings Plc				1 <sup>st</sup>	2 <sup>nd</sup>		Y	N
Grampian Holdings Plc		1 <sup>st</sup>					Y	nc
Grand Metropolitan Plc			1 <sup>st</sup>				Y	N
Grant Thornton	1 <sup>st</sup>				2 <sup>nd</sup>		Y	N
Grinyer JR	1 <sup>st</sup>						nc	N
Scottish Finance Directors	2 <sup>nd</sup>	1 <sup>st</sup>					Y	N
Guinness Plc		2 <sup>nd</sup>			1 <sup>st</sup>		Y	N
Halifax Building Society	2 <sup>nd</sup>	1 <sup>st</sup>					N	Y
The Hundred Group					1 <sup>st</sup>		Y	N
ICI Plc	1 <sup>st</sup>						Y	N
Inchcape Plc		1 <sup>st</sup>		2 <sup>nd</sup>			Y	N
ICAEW	2 <sup>nd</sup>				1 <sup>st</sup>		Y	N
ICAEW Faculty of Tax	nc	nc	nc	nc	nc	nc	nc	nc
Chartered Acc. Of Ireland		2 <sup>nd</sup>	1 <sup>st</sup>				N	N

Chartered Acc. Of Scotland	2 <sup>nd</sup>	1 <sup>st</sup>					Y	QS
Inst of Inv. Mgt & Research					1 <sup>st</sup>		N	N
Inst Fund Managers Assoc.					1 <sup>st</sup>		N	N
Interbrand UK Ltd			1 <sup>st</sup>				Y	Y
James JR	nc	nc	nc	nc	nc	nc	Y	nc
Kingfisher Plc					1 <sup>st</sup>		Y	N
Kingston Smith	1 <sup>st</sup>						Y	N
KPMG – London	1 <sup>st</sup>						Y	N
KPMG – Birmingham	2 <sup>nd</sup>				1 <sup>st</sup>		nc	N
KPMG – Leicester	1 <sup>st</sup>						nc	N
The Law Society	1 <sup>st</sup>						Y	nc
Marks & Spencer Plc				2 <sup>nd</sup>	1 <sup>st</sup>		nc	N
Midlands Industry Grp FD's	nc	nc	nc	nc	nc	nc	Y	N
Moore Stephens	1 <sup>st</sup>						nc	N
Morgan Grenfell & Co				1 <sup>st</sup>	2 <sup>nd</sup>		nc	nc
Myddleton DR	1 <sup>st</sup>						nc	N
National Power Plc					1 <sup>st</sup>		nc	nc
NatWest Securities		1 <sup>st</sup>					nc	N
News International Plc	1 <sup>st</sup>		2 <sup>nd</sup>				Y	nc
Pannell Kerr Forster	1 <sup>st</sup>		2 <sup>nd</sup>				QS	N
The Patent Office			1 <sup>st</sup>				Y	nc
Portsmouth & Sunderland News		1 <sup>st</sup>					N	nc
The Post Office					1 <sup>st</sup>		Y	N
Price Waterhouse		1 <sup>st</sup>			2 <sup>nd</sup>		Y	QS
Reckitt & Colman Plc					1 <sup>st</sup>		Y	Y
Reed Elsevier Plc	1 <sup>st</sup>						Y	QS
Reuters Plc		2 <sup>nd</sup>			1 <sup>st</sup>		nc	nc
Sainsbury J Plc		1 <sup>st</sup>					nc	N
Sciteb					1 <sup>st</sup>		Y	N
Scottish Equitable Plc	1 <sup>st</sup>						N	N
Sedgwick Group Plc				1 <sup>st</sup>	2 <sup>nd</sup>		N	N
Seton Healthcare Group Plc					1 <sup>st</sup>		Y	QS
Shell	1 <sup>st</sup>						Y	nc
Siebe Plc				1 <sup>st</sup>	2 <sup>nd</sup>		QS	N
SmithKline Beecham Plc	=1 <sup>st</sup>			=1 <sup>st</sup>			Y	nc
Smith New Court Securities	1 <sup>st</sup>				2 <sup>nd</sup>		N	N
Standard Life			1 <sup>st</sup>				N	N
Still Price Lintas Ltd					1 <sup>st</sup>	2 <sup>nd</sup>	Y	N
Stoy Hayward	1 <sup>st</sup>						Y	N
Strand BG		1 <sup>st</sup>					nc	nc
Tate & Lyle Plc	2 <sup>nd</sup>				1 <sup>st</sup>		Y	N
Taylor Joynson Garrett	nc	nc	nc	nc	nc	nc	nc	nc
TI Group Plc		1 <sup>st</sup>			2 <sup>nd</sup>		N	Y
Touche Ross Plc		1 <sup>st</sup>					Y	Y
TT Group				1 <sup>st</sup>			Y	nc
Unilever Plc	2 <sup>nd</sup>				1 <sup>st</sup>		N	N
United Biscuits Plc	1 <sup>st</sup>				2 <sup>nd</sup>		Y	nc
United Newspapers Plc				1 <sup>st</sup>			nc	N
Willis Corroon Group Plc	1 <sup>st</sup>						nc	N
Yorkshire Electricity Plc					1 <sup>st</sup>		N	N
Zeneca Group Plc	1 <sup>st</sup>						Y	N
<b>First choice – totals</b>	1 <sup>st</sup> 30	1 <sup>st</sup> 16	1 <sup>st</sup> 8	1 <sup>st</sup> 9	1 <sup>st</sup> 28	1 <sup>st</sup> 1	N=14	N=61
<b>Second choice – totals</b>	2 <sup>nd</sup> 8	2 <sup>nd</sup> 5	2 <sup>nd</sup> 4	2 <sup>nd</sup> 3	2 <sup>nd</sup> 9	2 <sup>nd</sup> 1	Qs=3 Nc=20 Y=59	Qs=7 Nc=22 Y=6

Key: 1<sup>st</sup> choice, 2<sup>nd</sup> choice, N= No support, Y= Yes supported, QS= Qualified support,

nc = *no comment* available/discernible or *no consensus* re group responses.

Of the six possible accounting methods for purchased goodwill, type A, B, C related to asset-based methods, and type D, E, F related to elimination-based methods. At the end the discussion paper (ASB, 1993, p43) they had been narrowed down to one accounting method per type, above. They were:

- (i) a combination of ‘capitalisation and predetermined life amortisation’ and ‘capitalisation and annual review’ [method C],
- (ii) a ‘separate write-off reserve’ [method E].

The support from respondents to the discussion paper for accounting methods C and E was 9% and 30% of respondents respectively, yet we know with the benefit of hindsight that method C was to eventually become the dominant accounting method despite the very low percentage. However, it is possible to decompose accounting method C into its constituent components, methods A and B as well as together as C in Table 6.1 and 6.2. When viewed from this perspective, support for asset-based approach to purchased goodwill rose to 59% of respondents, the largest support (33%) being for the capitalisation and predetermined life amortisation method, method A. One can see that there was majority support for the asset-based approach to the accounting recognition and disclosure of purchased goodwill early on in the process. In other words, the Board could have claimed that the respondents were supportive of international developments: that the recursive cycle presented in Figures 6.1 and 6.2 was operating in a positive manner in terms of structural change (a dominant coalition) towards asset-based approaches to goodwill. Surprisingly, the ASB did not address this advantageous point from their perspective in the subsequent working paper. Let us look at that working paper next (ASB, 1995a).

According to the Board's (1995a, p5) assessment in the working paper of the responses to the discussion paper, the accounting method that commanded "the greatest support, 34% of respondents, was for the immediate transfer of purchased goodwill to a separate goodwill write-off reserve" – method E. The analysis presented in Table 6.2 showed that, to repeat, the greatest support was for capitalisation and amortisation, method A (33%), rather than the write-off reserve method E (30%). Also, according to the working paper, "fifty percent of the respondents preferred capitalisation, with half of these opting for depreciation over a predetermined life, and half opting for an annual review only, at least in those cases where the goodwill involved was known to have a long life"(p5). To repeat, the figures in Table 6.2 showed that the percentages were actually 59% preferring capitalisation (methods A(33%)+B(17%)+C(9%)=59%) with only 17% opting for impairment reviews – method B. The fact that method C (9% support) was chosen in the working paper (ASB, 1995a, p7), rather than the dominant capitalise and amortise method A *alone*, made no empirical sense if one viewed the selection of the most dominant method as the basis on which to proceed further towards a consensus. So, in summary, first, the respondents were favouring capitalisation and amortisation, second, the Board, deliberately or otherwise, overstated the support for impairment. The results suggest that the existence of hybrid method C (capitalise/amortise plus capitalise/impair) was a vital compromise at this early stage if impairment was to be part of FRS10 in line with international developments and, subsequently, FRS11.

The summary analysis of the responses to the working paper (ASB, 1995c), Table 6.3, is presented in the same format as those presented in Table 6.2 in respect of the discussion paper. That is, despite the fact that the Board had already narrowed the accounting options

down to two only: a combination of ‘capitalisation and predetermined life amortisation’ and ‘capitalisation and annual review’ (column C, Tables 6.2 and 6.3) and ‘separate write-off reserve’ (column E, Tables 6.2 and 6.3). The reason for this situation was that there were many respondents who still rejected both options. Table 6.3 is presented as follows:

<b>Table 6.3</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>F</b>	<b>G</b>	<b>H</b>
<b>Respondent</b>	<b>Cap &amp; Amort</b>	<b>Impairment review</b>	<b>Com-bo A&amp;B</b>	<b>Immediate W/o</b>	<b>W/o Res</b>	<b>Res Reco v</b>	<b>Sep Intan</b>	<b>Impairment Test</b>
AIB Group				2 <sup>nd</sup>	1 <sup>st</sup>		Y	N
S Archer			1 <sup>st</sup>				Y	Y
Arthur Andersen				1 <sup>st</sup>			nc	nc
Assoc. of British Insurers		1 <sup>st</sup>				2 <sup>nd</sup>	Y	Y
WT Baxter		1 <sup>st</sup>					Y	nc
BOC Group			1 <sup>st</sup>				Y	nc
Boots Plc		2 <sup>nd</sup>			1 <sup>st</sup>		N	Y
British Telecomm. Plc			1 <sup>st</sup>				nc	QS
Cadbury Schweppes Plc			1 <sup>st</sup>				Y	QS
Chantrey Vellacott	1 <sup>st</sup>						Y	N
Chart Assoc of Certified A/c	Nc	nc	nc	N	N	N	Y	nc
Chart Institute of Mgt. A/c			1 <sup>st</sup>				Y	Y
Coats Viyella Plc					1 <sup>st</sup>		Y	N
Cooks Chartered A/c					1 <sup>st</sup>		Y	N
Coopers & Lybrand			1 <sup>st</sup>				Y	Y
Corp. Valuations Finance	nc	nc	nc	nc	nc	nc	Y	nc
D Damant		1 <sup>st</sup>					QS	nc
M and P Davies	1 <sup>st</sup>						QS	N
D Young & Co	Nc	nc	nc	nc	nc	nc	Y	nc
Ernst & Young	1 <sup>st</sup>						Y	N
ICAEW Faculty of Taxation	nc	nc	nc	nc	nc	nc	nc	nc
Glaxo Wellcome Plc				1 <sup>st</sup>			N	nc
H Gold	1 <sup>st</sup>						N	nc
Grand Metropolitan Plc		1 <sup>st</sup>					Y	Y
Grant Thornton			1 <sup>st</sup>				Y	N
JR Grinyer	1 <sup>st</sup>						nc	nc
Guinness Plc			1 <sup>st</sup>	2 <sup>nd</sup>			Y	Y
A Hartless		2 <sup>nd</sup>			1 <sup>st</sup>		nc	nc
C Higson	1 <sup>st</sup>						nc	N
Hundred Group of FD's			1 <sup>st</sup>				Y	nc
ICI Plc	nc	nc	nc	nc	nc	nc	nc	nc
ICAEW	nc	nc	nc	nc	nc	nc	nc	nc
Inst of Chart A/c in Ireland			1 <sup>st</sup>				Y	QS
Inst of Chart A/c – Scotland	nc	nc	nc	nc	nc	nc	nc	nc
Inst of Inv Mgt & Research	nc	nc	nc	N	N	N	N	Y
Interbrand Plc				1 <sup>st</sup>			Y	Y
Kalamazoo Comp. Solution	nc	nc	nc	nc	nc	nc	nc	nc
KPMG			1 <sup>st</sup>				Y	Y
Ladbroke Plc	1 <sup>st</sup>						Y	N
The Law Society	1 <sup>st</sup>						Y	nc
Leinster Soc. of Chart A/cs	1 <sup>st</sup>						N	nc
Liverpool Soc. of C. A/cs			1 <sup>st</sup>				nc	Y
London Inv. Banking Assoc				1 <sup>st</sup>			Y	nc
London Soc. Of Chart. A/cs			1 <sup>st</sup>				Y	QS



R Macve			1 <sup>st</sup>				nc	QS
Lancaster Univ. Mgt School				1 <sup>st</sup>			nc	nc
Marks & Spencer Plc					1 <sup>st</sup>		nc	nc
Moore Stephens	1 <sup>st</sup>						Y	nc
Morgan Crucible Plc				1 <sup>st</sup>			QS	N
DR Myddleton	1 <sup>st</sup>						nc	nc
Nat. Assoc. of Pension Fund	1 <sup>st</sup>						nc	N
M Page	1 <sup>st</sup>						nc	nc
KV Peasnell			1 <sup>st</sup>				QS	Y
Pilkington Plc			1 <sup>st</sup>				nc	nc
Price Waterhouse			1 <sup>st</sup>				Y	Y
Shell Plc			1 <sup>st</sup>				nc	nc
J Sainsbury Plc				1 <sup>st</sup>			nc	nc
Sedgwick Plc	**			2 <sup>nd</sup>			nc	N
B Shanthikumar	1 <sup>st</sup>						Y	N
Shield Diagnostics Plc***				N	N	N	nc	nc
Stakis			1 <sup>st</sup>				Y	Y
BG Strand			1 <sup>st</sup>				nc	nc
Thorn EMI Plc			1 <sup>st</sup>				nc	nc
Touche Ross Plc			1 <sup>st</sup>				Y	Y
TT Group Plc				1 <sup>st</sup>			Y	QS
Unichem Plc			1 <sup>st</sup>				Y	Y
Unilever Plc	2 <sup>nd</sup>			1 <sup>st</sup>			nc	N
Vodafone Plc	Nc	nc	nc	nc	nc	nc	nc	nc
Wassall Plc	2 <sup>nd</sup>			1 <sup>st</sup>			nc	nc
Yattendon Inv. Trust Plc			1 <sup>st</sup>				Y	QS
SA Zeff	nc	nc	nc	nc	nc	nc	nc	nc
Zeneca Group Plc			1 <sup>st</sup>				nc	QS
<i>Late Responses:</i>								
American Appraisal Ltd			1 <sup>st</sup>				Y	Y
BDO Stoy Hayward					1 <sup>st</sup>		QS	N
British Gas Plc			1 <sup>st</sup>				Y	nc
Clark Whitehill Chart A/cs			1 <sup>st</sup>				nc	N
CBI			1 <sup>st</sup>				Y	Y
Hanson Plc				1 <sup>st</sup>			nc	N
Rank Organisation Plc			1 <sup>st</sup>	2 <sup>nd</sup>			Y	nc
Reed Elsevier Plc		1 <sup>st</sup>					Y	Y
Standard Life			1 <sup>st</sup>				Y	Y
S&U Plc				1 <sup>st</sup>	2 <sup>nd</sup>		nc	nc
A Sugden			1 <sup>st</sup>				Y	nc
Trademark & Licensing Ass	nc	nc	nc	nc	nc	nc	Y	nc
UK Shareholders Assoc.			1 <sup>st</sup>				nc	nc
<b>Totals</b>	1 <sup>st</sup> =14 2 <sup>nd</sup> =2	1 <sup>st</sup> =5 2 <sup>nd</sup> =2	1 <sup>st</sup> =33 2 <sup>nd</sup> =0	1 <sup>st</sup> =12 2 <sup>nd</sup> =4	1 <sup>st</sup> =7 2 <sup>nd</sup> =1	1 <sup>st</sup> =0 2 <sup>nd</sup> =1	N=5 QS=5 Nc=33 Y=42	N=17 QS=8 Nc=40 Y=20

Key: 1<sup>st</sup> choice, 2<sup>nd</sup> choice, N= No support, Y= Yes supported, QS= Qualified support, nc= no comment available/discernible or no consensus re group responses.

\*\* 1<sup>st</sup> First choice amortise against reserves

\*\*\* Goodwill market value – balancing figure between market values and book values

With percentage figures in brackets referring to the equivalent discussion paper (ASB, 1993) response, Table 6.3 in respect of the working paper showed the following information. There was 46% (9%) support for the proposed hybrid method of

capitalise/amortise and retain/review – method C. If one also includes the individual constituent asset based methods of this hybrid, columns A and B, the figure rises to a majority at 73% (59%) of respondents. The Board could rightly claim an increasing consensus for asset based methods but there still remained some doubt about the ‘capitalise and impairment review’ approach to goodwill disclosures (accounting method B). There was a drop in the number of respondents choosing this method alone from 17% to 7%. However, it must be said that, given that they were not asked to specifically comment on this issue in the working paper, the decrease was not surprising. Nevertheless, it does beg the question of whether in choosing the hybrid method (accounting method C) respondents were primarily opting for the capitalisation and amortisation method (method A) and that they were prepared to accept the alternative method of capitalise and impairment review (method B) simply because there was no disadvantage in doing so. Indeed, there were many respondents who objected to the ‘capitalise and impairment review’ approach on the advantageous grounds to companies that it would allow a permanent asset status and no charge against profits in contrast to most of the other assets on the balance sheet. As it transpired from an analysis of post FRS10 accounting practices in a longitudinal survey (see appendix A), their concerns were unfounded. Most companies capitalised and amortised goodwill over its useful economic life, over a period not exceeding 20 years. Though speculative, it would appear that the respondents were prepared to embrace the flexibility of the hybrid method, method C, which allowed them to account on the basis of method A or B, with the vast majority in practice choosing the method A approach of capitalising and amortising goodwill. The point here in relation to Figure 6.3 is that the revised social structure posed by FRS10 would rightly show consensus support by the collectivity for asset-based approaches and for amortisation, *but not for impairment* which was nevertheless linked to this consensus through hybrid method C. This dialectic of

control was cleverly executed by the Board because impairment reviews entered FRS10 as a Trojan horse riding on the collectivity's support for capitalisation and amortisation. In this way the Board was able to steer the national agenda towards the international agenda, notably the US regulatory position in respect of impairment reviews.

By the time FRED12 (ASB, 1996a) was available for comment the focus of the Board was clearly upon accounting method C with reasons being sought for contrary views.

Respondents were still commenting on the theoretical aspects to the debate but generally these were simply additions to the comments expressed on the eight questions asked by the Board. In FRED 12 (ASB, 1996a, p7/8) the Board asked for responses to the following questions which have been summarised into a series of closed questions for the purpose of the subsequent analysis in Table 6.5. Those questions are presented in Table 6.4:

**Table 6.4: The questions asked of the respondents to FRED12**

Question one: Do you accept accounting method C - Yes/No

Question two: Do you support the 'rebuttable presumption' of 20 years - Yes/No

Question three: Are there events, in addition to those already identified in FRED12, which would indicate an impairment - Yes/No

Question four: Are the procedures for impairment meaningful and workable in terms of:

(a) It is possible to trace and measure goodwill after acquisition - Yes/No  
(b) Income generating units can be combined to assess the recoverability of goodwill - Yes/No

(c) There are ways in which the impairment procedures could be improved – Yes/No

Question five: Do you support the proposals for negative goodwill write-back to the Statement of Total Recognised Gains and Losses (not the P&L Account) – Yes/No

Question six: Do you believe that the disclosure requirements are sufficient and necessary in terms of:

(a) The disclosure of the fair value basis upon initial recognition of intangible asset – Yes/No

(b) The disclosure being in the notes to the accounts - Yes (No = Operating & Financial Review, instead.)

(c) Further disclosure required in addition to the disclosure of the carrying value of intangible assets by class – Yes/No

Question seven: Do you think the transitional arrangements are appropriate – Yes/No

Question eight: Do you prefer the alternative accounting method F – Yes/No

The responses to the questions presented in Table 6.4 are presented in Table 6.5.

Question: Table 6.5: FRED12 responses	1	2	3	4a	4b	4c	5	6a	6b	6c	7	8
Alderman R	Y	Y	Y	nc	N c	nc	Y	Y	Y	N	Y	N
Arrieta MG	Y	Y	Y	Y	Y	nc	Y	Y	Y	N	Y	N
AIB Group	N	Y	N	N	Y	Y	N	Y	Y	N	Y	Y
Arthur Andersen	N	N	N	N	nc	N	N	Y	N	N	N	Y
Association of British Insurers	Y	Y	Y	Y	Y	N	N	Y	Y	N	Y	Y
Bass Plc	N	N	N	N	N	Y	N	Y	Y	N	Y	Y
Baxter H	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
BDO Stoy Hayward	A	Y	N	N	N	N	N	Y	Y	nc	Y	N
Bloomfield DL	N	nc	Y	nc	nc	nc	nc	nc	nc	nc	nc	nc
The Boots Company Plc	nc	Y	N	nc	nc	nc	nc	nc	nc	nc	nc	nc
British Bankers Association	nc	Y	N	N	Y	Y	N	Y	Y	N	Y	nc
Cadbury Schweppes Plc	Y	Y	N	Y	Y	Y	Y	Y	Y	N	Y	N
ACCA	Y	Y	N	N	nc	nc	N	Y	Y	N	Y	N
CIMA	Y	Y	N	N	Y	N	Y	Y	Y	N	nc	N
University of Liverpool	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
CBI	nc	nc	N	Y	Y	Y	N	Y	N	N	N	nc
Coole RN	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
Coopers & Lybrand	Y	Y	N	N	N	Y	Y	Y	Y	N	Y	N
Davies M & P	A	N	N	N	N	N	N	Y	Y	nc	nc	N
Deloitte & Touche	Y	Y	N	nc	nc	nc	N	Y	Y	N	Y	N
EMI Group Plc	Y	Y	N	nc	Y	Y	Y	Y	Y	Y	N	Y
Ernst & Young	A	Y	N	N	N	N	N	N	nc	N	N	N
Flying Flowers	N	N	N	N	N	N	nc	nc	nc	nc	nc	N
GlaxoWellcome Plc	N	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	N
Grand Metropolitan Plc	Y	nc	Y	nc	nc	nc	N	nc	nc	nc	nc	nc
Grant Thornton	Y	Y	N	nc	nc	nc	N	Y	Y	N	Y	N
Guinness Plc	Y	Y	N	Y	Y	Y	N	Y	N	N	N	nc
Hicks Randles & Co.	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
Holmes SP	A	nc	N	N	N	N	Y	nc	nc	nc	nc	nc
The Hundred Group	Y	Y	Y	nc	nc	nc	nc	nc	nc	nc	nc	nc
HW Fisher & Co	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
ICI Plc	Y	Y	N	Y	Y	N	N	N	N	N	nc	N
Independent Newspapers Plc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	N	nc
ICAEW	Y	Y	N	Y	Y	N	N	nc	nc	nc	N	Y
1 Inst of Chartered A/c Ireland	Y	Y	Y	N	nc	Y	N	Y	Y	N	N	N
2 Inst of Chartered A/c Ireland	Y	Y	N	nc	Y	Y	N	Y	Y	nc	N	N
Inst of Chartered A/c Scotland	Y	Y	Y	Y	Y	N	N	Y	Y	N	N	N
ICSA	Y	Y	N	Y	Y	N	Y	Y	Y	Y	Y	N
IIMR	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N
IFMA	Y	Y	N	nc	nc	nc	Y	Y	Y	N	Y	N
Kingston Smith	Y	Y	N	Y	nc	N	N	nc	nc	nc	N	N
KPMG	Y	Y	N	nc	Y	Y	N	Y	Y	N	N	N
The Law Society	A	N	Y	nc	nc	nc	nc	nc	nc	nc	nc	N
Lion Nathan	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
LIBA	N	N	N	nc	nc	nc	Y	Y	Y	N	Y	N
Marks & Spencer Plc	nc	Y	N	N	Y	N	N	Y	Y	N	Y	Y
Myddleton DR	A	N	Y	N	N	N	N	Y	Y	N	N	N
News International Plc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	N	nc
Orange Plc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	N	nc
Pannell Kerr Forster	A	Y	N	N	N	N	nc	Y	Y	Y	Y	N
Pemberstone	nc	nc	nc	nc	nc	nc	N	nc	nc	nc	nc	nc
Pope RC	nc	nc	nc	Y	nc	nc	N	nc	nc	nc	nc	nc

The Post Office	Y	Y	N	Y	N	Y	Y	Y	Y	N	Y	N
Price Waterhouse	Y	Y	Y	Y	Y	Y	N	N	N	N	Y	N
Reed Elsevier Plc	Y	Y	N	Y	Y	Y	N	Y	Y	N	Y	N
Sage Group Plc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
Scottish & Newcastle Plc	N	nc	nc	N	nc	nc	nc	nc	nc	nc	nc	nc
Scottish Power Plc	Y	Y	N	nc	nc	nc	Y	nc	nc	nc	Y	N
Seton Healthcare Group Plc	nc	nc	Y	nc	nc	nc	nc	nc	nc	nc	nc	nc
Shell International Ltd	Y	N	nc	nc	nc	nc	nc	nc	nc	nc	nc	nc
Siebe Plc	N	N	Y	N	N	N	N	Y	Y	N	N	Y
South African Breweries Ltd	Y	N	nc	nc	nc	nc	N	Y	nc	nc	nc	nc
Stakis Plc	Y	Y	N	nc	nc	nc	nc	nc	nc	nc	Y	N
Standard Life Plc	Y	N	N	nc	nc	nc	nc	nc	Y	nc	nc	N
Standex Holdings Ltd	A	nc	nc	nc	nc	nc	N	nc	nc	nc	nc	nc
Tate & Lyle	Y	Y	N	N	nc	nc	N	Y	Y	N	Y	N
Trent Services Ltd	Y	nc	Y	Y	Y	nc	N	Y	Y	nc	N	N
Unilever Plc	N	N	N	N	Y	N	N	Y	Y	N	Y	N
Vodafone Plc	Y	N	Y	nc	nc	nc	N	nc	nc	nc	nc	nc
Willis Corroon Plc	Y	N	nc	N	nc	nc	N	Y	Y	nc	N	N
Y	35	35	16	16	21	15	13	37	34	4	25	8
N	10	14	36	21	11	18	35	3	5	30	18	36
nc	17	21	18	33	38	37	22	30	31	36	27	26
A	8											

Key: Y = Yes N = No  
nc = No comment made or,  
No clear view expressed in response to the question or,  
No consensus where a group view was expressed.  
A = Accounting method A only supported.

The responses to Table 6.5 may be summarised in percentage terms in Table 6.6.

Question:	1	2	3	4a	4b	4c	5	6a	6b	6c	7	8
Table 6.6: FRED12 responses												
Yes %	50	50	23	23	30	21	19	53	49	6	36	11
No %	14	20	51	30	16	26	50	4	7	43	26	52
Nc %	24	30	26	47	54	53	31	43	44	51	38	37
A %	12											

A striking feature of the above analysis was the high incidence of no clear view or 'nc' responses, particularly in respect of the questions relating to the impairment reviews (4a,b,c). In most cases there was some kind of response, which could not be accommodated in an analysis using closed questions. This, of itself, was to be expected because of the earlier strength of views in opposition to the Board's proposals whilst, paradoxically, offering comments at this late stage in the consultation process in such a way so as to, perhaps, not be seen as standing in the way of progress. There was no formal follow-up clarification process and the task was an improbable one for the author to

perform eight years after the event. The ‘nc’ response raises a point that is worthy of explication. The recursive cycle of social structure and social action tends to be viewed supportively or not as the case may be. But what happens if a supported element of a revised structure (amortisation) is linked together with an unsupported element (impairment) to also be included in that revised structure? The result, it is suggested, is that the outcomes from this process show mixed or confusing signals and that is, perhaps, why there is such a high incidence of ‘nc’ responses. To Giddens, perhaps, this would not be surprising because “ structural principles operate in terms of one another but yet also contravene each other” (Giddens, 1984, p193).

In some ways the high incidence of ‘nc’ is a story in its own right. For example, at this late stage in the consultation process, the respondents had, at least, acquiesced in the adoption of the Board’s chosen hybrid method C - see Table 6.6. Specifically, there was 50% support amongst the respondents to method C and 62% for capitalisation if one also included the lingering support for method A alone (capitalise and amortise) rather than as an option under method C.

Consider another issue in respect of the responses to FRED12: the ‘reluctant’ support of actors for impairment reviews at this late stage in the consultation process can be considered from the correspondingly low level of ‘Yes’ responses to questions 4a - see Table 6.5. Specifically, the fact that the ‘traceability’ of purchased goodwill was fundamental to any determination of impairment and that, respectively, a high level of ‘Yes’ responses to question 4a would have been complimentary to the high, actual level of ‘Yes’ responses to question 1. Now, consider instead the actual dominant ‘nc’ response to question 4a in comparison to the actual dominant ‘Yes’ response to question 1. Though

speculative, could it be that the respondents, having approved the adoption of impairment as part of accounting method C, were reluctant to also record a contradictory 'No' response to the 'impairment review' question 4a? And, therefore, they effectively recorded a 'nc' response instead, in often hostile terms.

Another interesting feature of the analysis of the responses to FRED12 was the existence of an alternative method F – question eight. When one considered that there were altogether only nine positive responses from the respondents to the discussion paper, working paper and exposure draft on this accounting method it was doubtful whether this method should even be considered at this late stage. The only logical explanation was that it was the choice of one dissenting Board member but, if correct, this offering had nothing to do with the consultation process. In effect, it was internally focused, not externally focused because it had, previously, already been rejected by the respondents.

#### *Summarising so far*

The review presented so far in this section suggests a different interpretation of the views of the respondents from the Board's initial assessment of them. In fact, it is an interpretation that actually supports the Board's evidential predisposition towards asset-based approaches in support of the domination structure but not in respect of impairment reviews. The reasons for the largely adverse responses by the respondents to impairment reviews may be summarised as follows:

- The inherent subjectivity in the construction of cash flow projections and in the selection of an 'appropriate' discount rate.
- The difficulty in discriminating between cyclical and non-cyclical industries.

- The difficulty in discriminating between cash flows for internally generated goodwill and externally purchased goodwill.
- The contradiction of discounted cash flow projections being ‘acceptable’ under FRS11 but not for the valuation of certain intangible assets under FRS10, notably brands.
- The use of the true and fair override. It set a poor standard, which some thought would encourage companies to seek out other ways to use the override.
- The assertion that cash flows tend to be positive as a company reaches its demise. Conversely, cash flows can be negative as a successful company expands. Therefore, cash flows are a misleading measure for impairment purposes.
- The reassertion of the concept of ‘prudence’, which tends to favour ‘systematic amortisation’ over ‘impairment reviews.’
- The assertion that the ASB’s field tests were based upon the selection of a biased target audience.

The linkage of capitalise/amortise with capitalise/impair was therefore a clever one to make because the respondents appeared to be reluctantly willing to embrace both accounting methods for the sake of actually using only one of them: capitalise/amortise. It is clear with benefit of hindsight that both the national agenda, as ultimately portrayed in FRS11, and the international agenda was going to wholeheartedly embrace capitalise/impair come what may, but, at the time of the consultation process it was, nevertheless, comprehensively rejected by the respondents. This speaks directly about the effectiveness of the consultation process and the lack of power of the respondents to effect change where the overwhelming majority of their opinions were simply overridden. The power therefore rests with the Board to direct change. This gives rise to the speculative conclusion that the purpose of the consultation process had more to do with legitimisation rather than domination since the exercise of power was a mainly a one-sided affair.



That said, there was one issue on which the Board had to bend towards the wishes of the respondents and that was on the separable disclosure of other intangible assets on the balance sheet (column G, Table 6.2 and Table 6.3). With regard to the separable capitalisation of intangible assets, the Board expressed in the working paper that the responses to the discussion paper were not clear-cut except with regard to the belief that all intangible assets should not be subsumed within purchased goodwill. The initial stance of the Board was to subsume all intangible assets within purchased goodwill (see ASB, 1995a, p5). Indeed, the analysis of Table 6.3 confirmed that 61% of the respondents to the discussion paper did not believe that intangible assets should be subsumed within purchased goodwill. The figure rises to 82 % if one ignores those respondents who did not express a clear view on this issue. If one then examines Table 6.3 the latter equivalent figure would be 90% of the respondents to the working paper. As a consequence the Board, early on, relaxed its approach to intangibles to allow their recognition separately from purchased goodwill provided their fair value could be measured reliably (see ASB, 1995a, p6). In this instance the dialectic of control appeared to be ‘fully operational’: the subordinates affecting the policy decisions of the superiors, but was it in reality? In reality, this ‘relaxation’ did not involve any move towards the widespread use of valuations, rather, any valuation had to be benchmarked against a market of equivalent assets for which there was evidence of numerous transactions-based costs (readily ascertainable market values or RAMVs). The effect of this requirement was to give the appearance of greater flexibility towards the separable disclosure of intangible assets but actually, the effect in practice was often to reverse previous capitalisations where they did not meet these requirements (see United Biscuits Plc 1998 accounts). In other words, FRS10

reinforced the signification structure by removing many of the anomalous practices that complied with that structure but which the Board, nevertheless, frowned upon in practice.

Whilst the Board was obliged in the working paper to allow the separable disclosure of intangible assets subject to the overriding requirement for reliability of measurement, the Board would, nevertheless, regard them as the same thing as purchased goodwill from an accounting viewpoint where they were both capitalised post FRS10 (see ASB, 1995x, p4/5). It made little difference whether one referred to them on two lines of the balance sheet as 'goodwill' and 'intangible assets' or combined them on one line as 'goodwill', any difference being presentational. The key point was that both of them would be capitalised in line with the dominant international structure. Thus, the attachment of the one for the other is a strong one in accounting. Yet, there is no conceptual basis to this linkage other than in the context of the existing transactions-based signification structure. Indeed, it is hard to think of another situation in accounting where the existence of one group of assets, intangible assets, is so heavily dependent on the existence of another 'asset', a goodwill 'asset' (if it be one!). Because of that linkage it became important to have similar accounting practices and thus avoid the scope for accounting arbitrage through the sort of differential practices which occurred previously under SSAP22 (ASC, 1989b). The power of the Board was thus exercised to maintain comparability between financial statements and the best way to do that was by adopting the dominant international structure of capitalising purchased goodwill.

There was one further important development that flowed from the domination structure. The domination of the international structure of capitalising goodwill also solved a fundamental problem that was, at that time, dominating at the national level: excessive

reserve depletion arising from the writing-off of purchased goodwill against reserves, per SSAP22 (ASC, 1989b). As was shown in section 2.7 this was causing the reserve balances on many balance sheets to become negative (see also Appendix A). It was a problem compounded by attempts to mitigate reserve depletion by extracting all manner of other intangible assets from the purchased goodwill written-off and capitalising them separately on the balance sheet. It was this strategy that was causing “accounting arbitrage” where the balance between the goodwill write-off and the separable capitalisation of intangibles extracted from it could be manipulated to alter the respective reserve balances and the asset base of a company. Accounting arbitrage was also a serious threat to the signification structure because the next logical step to allowing intangible asset valuations, extracted and capitalised separately from the purchased goodwill, would be to allow intangible asset valuations to be capitalised independently from purchased goodwill. Both reasons constitute a powerful nationally-based incentive to the Board to be rid of the SSAP22 reserve-write-off approach as quickly as possible in favour of the international approach. Before moving on to the next section it is perhaps worth explicating the nature of accounting arbitrage since it is a complex manipulation to grasp fully.

Accounting arbitrage in the **pre FRS10** context of purchased goodwill written-off to reserves refers to the ability of a company to legitimately manipulate accounting practice so as to separately capitalise and disclose specific intangible assets, as extracted from the purchased goodwill written-off and, thereby, to improve reported levels of reserves and the asset base of the company. Let us explore this statement in relation to column 3 in Table 6.7. Balance sheet one shows a reduction of £40 in the reserves due to the purchased goodwill write-off whereas balance sheet two shows only a £20 reduction. The asset base also improves from £960 to £980, respectively. This is because of the extraction from

purchased goodwill (£40) of identified intangible assets (£20) which have been capitalised instead, often without amortisation. For example, all the brand accounting companies in the longitudinal survey (appendix A) used this approach to disclose on the balance sheet those brand valuations extracted from purchased goodwill (and from no other context). ED52 (ASC, 1990b) argued instead for this type of 'accounting arbitrage' not to occur, however, in the absence of a brand accounting standard, it continued. The scope for accounting arbitrage is therefore determined by the amount of goodwill (£40) which, depending on the amount of intangibles extracted from it, would result in a disclosure of reserves in the range of £960 to £1000. It is a substantial variation which was reduced considerably by adopting, in FRS10, the international practice of capitalising goodwill - to be examined next.

Accounting arbitrage in the **post FRS10** context of capitalised purchased goodwill refers to the effect on reported profits of differential rates of impairment and/or amortisation. Thus, whilst some flexibility remained, the impact on reported was substantially diminished. Let us explore this statement in relation to columns 4 and 5 in Table 6.7. The differences between balance sheets one and two are minimal, that is, purchased goodwill with intangible assets subsumed within it (balance sheet one) or a reduced purchased goodwill figure matched by an equivalent amount of separately capitalised intangible assets (balance sheet two). Column 5 shows no impairment whereas column 4 shows a small amortisation charge. There is little difference in the reported level of reserves or the amount of goodwill capitalised. That difference, such as it is, relates to the annual amortisation charge which is  $(5\% \times £40) = £2$  in balance sheet one where goodwill alone is amortised and  $(5\% \times £20) = £1$  on balance sheet two where, again, goodwill alone is amortised (as shown). It is entirely possible though in balance sheet two for both goodwill

**Table 6.7: A scenario of a company acquisition and the effect of arbitrage**

The pre and post-acquisition situation is, respectively, set out in columns 1 and 2. A company purchases a business for £100 cash obtaining £60 in fixed assets and £40 in goodwill. Part of the purchased goodwill relates to other intangible assets, which are assumed to have a value of £20. Amortization charges are over twenty years.

Column 3 is the dominant pre-FRS10 accounting practice. Columns 4 and 5 are the two allowable post-FRS10 accounting practices.

Balance sheet one: goodwill accounting methods only

Balance sheet two: goodwill and other intangible assets.

Balance sheet one	Pre acq.	Post acq. Invest- ment	Pre FRS10	Post FRS10	
			GW reserve write-off	GW asset Amortise	GW asset Retain & Impairm't review
<i>Assets:</i>	Column 1 £	Column 2 £	Column 3 £	Column 4 £	Column 5 £
Cash	500	400	400	400	400
Other assets	500	500	560	560	560
Goodwill (GW)				38	40
Investment		100			
<i>Financed by:</i>					
Capital	700	700	700	700	700
P&L Reserve	300	300	260	298	300
GW Reserve					
P&L expense				(2)	
Balance sheet two	Pre acq.	Post acq. Invest- ment	GW reserve write-off	GW asset Amortise	GW asset Retain & Impairm't review
<i>Assets:</i>	Column 1 £	Column 2 £	Column 3 £	Column 4 £	Column 5 £
Cash	500	400	400	400	400
Other assets	500	500	560	560	560
Goodwill (GW)				19	20
Other intangibles			20	20	20
Investment		100			
<i>Financed by:</i>					
Capital	700	700	700	700	700
P&L Reserve	300	300	280	299	300
GW Reserve					
P&L expense				(1)	

and other intangibles to be amortised ( $5\% \times (£20 + £20)$ ) = £2 in which case the differences

between balance sheets one and two are purely presentational. David Tweedie (ASB,

1995x, p4 5) referred to this 'presentational' point in the following terms:

“Intangible assets can be recognised if the fair value can be assessed reliably, but the treatment of intangibles and goodwill are closely aligned, so there is no accounting arbitrage, there is not an advantage to call it either a brand or goodwill.”

Compared to the pre FRS10 situation, the post FRS10 scope for accounting arbitrage is reduced considerably in respect of both FRS10 allowable practices: capitalise/amortise (column 4) and capitalise/impair review (column 5) – see section 2.7 again. When the UK eventually switches over to the capitalise/impair review approach (single method approach) in line with the international structures then the scope for accounting arbitrage will have been reduced even further.

Post FRS10, the accounting treatment of goodwill and intangible assets is indeed more “closely aligned” but there is still some scope for arbitrage to occur. Consider, for example, a pharmaceutical licence purchased as part of the purchase of a Chemists shop, specifically, where the licence is not amortised and where purchased goodwill is amortised. The attachment of any purchased goodwill to the valuation of the capitalised pharmaceutical licence will provide a means of avoiding goodwill amortisation charges and vice versa. Professor Whittington (ASB, 1995z, p37) said to Christopher Nunn, an advocate for the separable disclosure of intangible assets (see ASB, 1995c, p9),

“...you were very dismissive of our concern with accounting arbitrage, but of course, it is difficult to separate the two [goodwill and other intangible assets]. To have extremely opposite attitudes which you do to the two sides of this rather ill-defined borderline, seems to invite the sort of abuse of accounting which you seem anxious to avoid. Would you not agree with that?” (brackets added).

In reply, Mr Nunn said,

“...no, I think the abuse will be trying to force a uniform treatment on unlike items...”.

Mr Nunn believed the capitalisation of goodwill to be conceptually flawed and that “there is a strong conceptual argument for writing it off directly against equity when it arises...”(see ASB, 1995z, p35).

Professor Whittington, above, appeared to adopt a strict transactions-based measurement approach which would accurately measure the residual purchased goodwill figure from a business acquisition but not necessarily any intangible asset ‘hiding’ within it. In this sense they are one and the same item and it does not matter that an intangible asset could be separated from purchased goodwill (though he challenges whether this is possible anyway) because the combined cost equates to a known element, the acquisition cost. Thus, accounting arbitrage is largely avoided (i.e. columns 4 and 5, Table 6.7 again).

#### *Summarising accounting arbitrage*

The willingness of companies to apply accounting arbitrage highlights again the two-way power dynamics of the dialectic of control. Post-FRS10, the power of the subordinate (companies) to manipulate the presentation of goodwill and intangible assets on the balance sheet contrary to the wishes of the superior (the Board) is now reduced. However, one only has to view Appendix A and the recent additions to the brand asset fraternity presented there, such as Allied Domecq Plc and Reuters Plc, to realise that accounting arbitrage continues to represent a serious threat to comparability between accounts as well as to the signification structure, for the reasons outlined earlier. Such tactics suggest that where the views of respondents are ignored or overridden by the Board in their construction of financial reality, the respondents may register a protest by constructing a legitimate variant to it within the existing rules of accounting, brand accounting being the main case in point.

### 6.1.3 Cycle one: The use of resources

Returning again to Figure 6.2, the link between social structure (Box A) and social action (Box C) refers to modes of mediation between them, in this case, through the use of resources. There are two types of resources: allocative and authoritative. In the context of this rule creation cycle, allocative resources were directed towards the financing of the consultation process itself, that is,

“...allocative resources which arise from command over objects, goods and other material phenomena” (Macintosh and Scapens, 1990, p461)

This included venues for a public hearing, the recording of verbal evidence, the collation, analysis and reporting of respondent comments, whereas,

“...authoritative resources...arise from capabilities to organize and coordinate the activities of social actors. Both types of resources facilitate the transformative capacity of human action (power in the broad sense), while at the same time providing the medium for domination (power in the narrow sense).” (Macintosh and Scapens, *ibid*)

The two ‘senses’ are often linked. For example, the direction and control of the consultation process, presented in section 6.1.2, is an example of the exercise of authoritative power in the broad sense, whereas, the power of the Board to selectively ignore consensuses on specific aspects of that process (impairment reviews?) is an example of authoritative power in the narrow sense.

A conclusion of the Board in the working paper (ASB, 1995a, p5) was that the separable recognition of intangible assets (as opposed to their subsumption within purchased goodwill) was the only “clear-cut” issue from the consultation process was incorrect because, as has been shown already, there was also a clear majority in favour of asset-based methods (though not for the Board’s preferred hybrid option – accounting method



C). Also, in this latter regard, there was the emphatic or “clear-cut” rejection of the ceiling tests or impairment tests, a vital feature of this preferred hybrid accounting method C. Yet, these facts were omitted from the ASB’s “clear cut” assessment of the discussion paper in the subsequent working paper. It is possible that the ‘majority in favour of asset-based methods’ presented earlier was simply an oversight or the result of poor analysis but the emphatic rejection of the impairment approach to purchased goodwill cannot be construed as anything other than a deliberate use of the Board’s authoritative resources to steer the consultation process towards the inclusion of impairment in FRS10. It represents the exercise of its powers to override the wishes of a large majority of respondents who were against the adoption of impairment. Of the vast majority of respondents who expressed a view on the ceiling tests (as impairment was referred to in the discussion paper) 82% of them did not support the approach. Thus, it may be argued that cycle one is, in respect of these points, a negatively reinforcing one: social action is not supportive of the social structure where authoritative resources are applied to override the wishes of the majority. In effect, it was a process of consultation that was not intended to seek a consensus, particularly so, where that consensus would have undermined the emerging ‘international association’ in respect of impairment reviews.

The discussion paper presented six accounting methods for consideration by respondents but at the same time the Board applied its authoritative resources to recommend two methods. These two methods were therefore not the product of a majority consensus because no consultation had, at that time, been undertaken. Likewise, before the respondents to the subsequent working paper had responded on the merits of these two recommendations, the Board, again, applied its authoritative resources in the working paper to recommend one method, method C. Coats Viyella Plc (ASB, 1995c, p44, brackets

added), for example, were not impressed by this rapid narrowing of accounting choice down to only one method:

“We note that our preferred treatment, the separate goodwill write-off reserve, was the method commanding greatest support [according to the Board] is not mentioned in the working paper – so much for the consultation process!”

Clearly, there were still many respondents who were unhappy about the consultation process. This is why it was possible, despite the application of authoritative resources to narrow accounting options in the working paper, for the analysis of the responses to the working paper (Table 6.3) to follow the same tabular format as the discussion paper (Table 6.2); namely, that the respondents did not wish to be restricted and steered by the pace of recommendations being advanced by the Board. It is an example of the two-way use of power in the dialectic of control. Nevertheless, the Board was able to use the greater power it possessed to steer the consultation towards its own predisposition for accounting method C despite the evidence from the respondents that method A was the better choice, for the reasons explored previously.

The power to shape reality in this regard was expressed in terms of preferences for accounting methods. The power to shape reality was not grounded on conceptual issues such as the asset status of goodwill in relation to the signification structure. The author has argued that had the Board done so and, say, concluded that goodwill was an asset, then clearly, elimination accounting methods D,E,F would not have even been considered. The converse in respect of asset-based methods A,B,C is also true. However, the danger was that the debate would have been broadened to a point where the specific issue of goodwill and intangible assets was lost in the search for the general conceptual foundations of accounting, as with previously inconclusive attempts at a conceptual framework in the US. Indeed, though speculative, it is argued that the last thing the Board would have wanted

was a comprehensive challenge to the existing signification structure since, in all probability, it would have led to never-ending cycle of debate, a feature of the literature for many decades. To conclude, it is suggested that closure on this vexed issue through the use of the Board's authoritative resources was a vital motivator in its actions.

Nunn (ASB, 1995z, pp36/37) comments, closure may have actually resulted from exhaustion rather than a consensus:

"I am well aware of the enormous effort which the ASB has put in to try to formulate proposals which will obtain consensus support. However, my perception is that if such a consensus is obtained it will be a fragile one, based partly on exhaustion with debating the topic and partly on a feeling amongst preparers that the important issue is to secure the ability to capitalise intangibles, particularly brands, and that the goodwill proposals, while arousing little positive enthusiasm and receiving quite a lot of objection, are sufficiently flexible to be lived with and finessed as necessary. I do not think this is a satisfactory platform from which to proceed. I therefore find myself in the perhaps politically incorrect position of having to say that so far as the goodwill proposals are concerned the emperor, in the form of the ASB, has rather flimsy clothes."

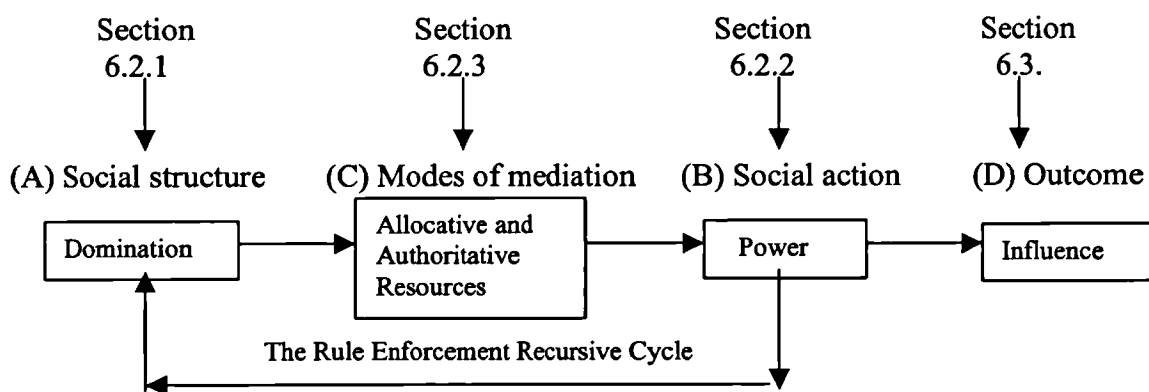
The striking feature of the final FRS10 rule was, indeed, that it was "sufficiently flexible to be lived with and finessed as necessary" as Nunn suggests. That flexibility arose because the consultation process was successfully steered by the Board towards a compromise rather than a consensus. That compromise, based on a dual-track accounting method approach (Method C), included impairment reviews, an accounting method for which there was clearly very little support. What flows from this situation is addressed in the 'outcomes' section, section 6.3. Before that, let us address next the recursive cycle two: the rule enforcement recursive cycle in section 6.2.

## 6.2. Cycle two: The recursive cycle of rule enforcement

Cycle one was about constructing an asset-based, and internationally dominant, version of financial reality as far as goodwill and intangible assets are concerned and cycle two, below, is about enforcing the dominance of it as a true and fair view of financial reality. The two cycles are linked and centred upon the dominant position of the profession (section 5.2) in the construction and enforcement of their version of financial reality within the boundaries of the signification structure.

The recursive domination cycle presented in Figure 6.1 is repeated here as a 'rule enforcement recursive cycle', in Figure 6.4 below. The recursive elements of Figure 6.4, that is, structure, action and resources are addressed sequentially in three subsections 6.2.1 to 6.2.3 and then summarised in terms of their related outcomes in section 6.3.

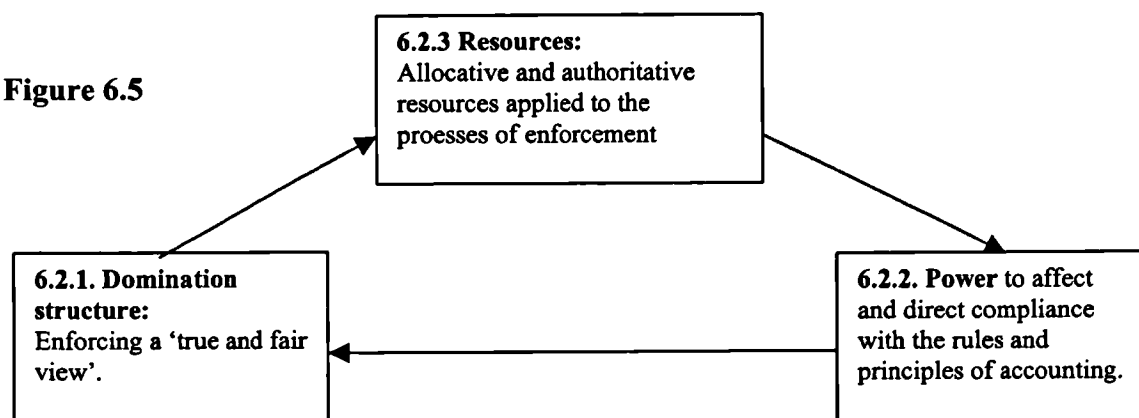
**Figure 6.4: The process of domination (cycle two)**



(Adapted from Macintosh, 1994, p173)

The three recursive elements of Figure 6.4 are summarised in Figure 6.5.

**Figure 6.5**



A rule change, such as FRS10, should lead to a change in behaviour in full compliance with the new rule. Thus, new rules means a new portrayal of accounting truth and fairness widely supported by compliant social action and audited to that effect. As Roberts and Scapens (1985, p446) comment:

“Through being drawn upon by people, structures shape and pattern (i.e. Structure) interaction. However, only through interaction are structures themselves reproduced. This is the ‘duality of structure’; it is in this way that structures can be seen to be both the medium and the outcome of interaction.”

Indeed, a longitudinal study (appendix A) shows that the social action of compliance with FRS10 by the vast majority of accounting actors reinforces the duality of structure. Thus, the cycle presented in Figure 6.5 is a positive one with the power to ‘affect’ FRS10 rule compliance being linked to the need to obtain a ‘true and fair view’ audit opinion.

In contrast, the failure to comply with those rules risks undermining the social structure posed by accounting standards and auditing standards and, by extension, the institutional structures that promulgate them. Under such circumstances a negatively reinforcing cycle exists in Figure 6.5 and, hence, the power to ‘direct’ rule compliance comes into play to prevent this situation occurring.

Whilst the ability to effect rule compliance constitutes a valid, though somewhat passive exercise of power, it is the power to direct rule compliance that is, perhaps, more pertinent to the issue of enforcement, to be explored here. The power to affect rule compliance is really an issue for the auditors themselves in the first instance through the threat and use of adverse audit opinions. The power to direct compliant accounting behaviour is by reference to the Financial Reporting Review Panel and in the application of authoritative resources to enforce their rulings (see section 6.2.2 and 6.2.3, below).

#### **6.2.1. Cycle two: The domination structure of enforcing a true and fair view**

As we saw in section 5.4.1, audit opinions about ‘truth and fairness’ are inherently subjective in nature and, as such, tend to be based on the relative objectivity of compliance with accounting rules and principles. These rules are given backing under s36, Sch.4, Part IIIB of the Companies Act 1985. The concept of truth and fairness, for example, precludes the over/under statement of ‘material’ amounts, the disclosure of ‘misleading’ or ‘ambiguous’ descriptions of figures, the presentation of ‘obscure’ or ‘complicated’ information – all determined by professional opinion as a compliment to the application of the formalistic rules of accounting. In drawing upon this structure, the profession

“...assumes that law [and accounting standards] is ‘intelligible as an internally coherent phenomenon,’ that there is consistency, predictability, logical coherence and ultimately autonomy and ‘closure’: a systemic isolation of the legal system from such things as politics and culture” (McBarnett and Whelan, 1991, p849, brackets added).

The problem with such an approach is that the accounting rules may be seen as artificial and hence, may encourage actors to find ways to circumvent or undermine them by using the perceived weaknesses of the rules themselves (see, for example, Griffiths, 1986). Equally, the danger of exclusively enforcing compliance with the accounting rules is that it

can lead to the defeat of policy. It is a policy that clearly over the past twenty years or so has been directed towards reporting economic substance over legal form in the accounting portrayal of a 'true and fair view' of financial reality. The conceptually eclectic 'marriage' of economic substance and legalistic form of accounting standards (reference FRS5) is a problematic one on which to construct a true and fair view, let alone for that view to dominate. Nevertheless, the legalistic basis to that 'marriage' is enforced:

"The purpose of enforcing accounting standards [other legalistic rules] under which financial information is prepared is to increase the confidence of a wide range of users in the reliability of the information relevant to their varied economic decisions. These decisions include, but are not restricted to, the economic decisions of investors and potential investors." (FRRP1, p8, brackets added)

For example, in respect of internally generated intangible assets, the disclosure of their economic substance is overridden by the legal form for asset recognition to be transactions based. As rule changes, such as FRS10, arise so the balance between the economic and legal perspectives are readjusted with neither discipline dominating for the following circular reasoning:

"New situations arise and new rules are produced to deal with them. But new rules cannot control creative compliance. How do you control those playing by the rules? New rules simply mean new games. No rules, rules broad enough to be flexible in application, mean resistance, and the use of legal structures and ideologies to re-establish working rules, which can then be manipulated" (McBarnett and Whelan, 1991, p873).

Whilst the structural conflict between a legal rules-based approach to enforcing a 'true and fair view' of economic reality is brought into sharp focus on the issue of internally generated goodwill and intangible assets, that is not the issue here. This is because they mainly arise outside the scope of the current signification structure. Thus, the related issue of enforcement is largely irrelevant in that regard. What is pertinent here is where a positive audit opinion is given on the truth and fairness of a set of published accounts and yet those same accounts still show inherent contradictions in the way intangibles in general

are disclosed. Such instances undermine the domination structure because enforcing a true and fair view becomes contestable within the existing signification structure. Consider the following example from the longitudinal survey presented in appendix A.

In disclosing certain national and Scottish newspaper titles on their pre-FRS10 1997 balance sheet the Mirror Group Plc state that:

“The historic cost of these titles is not disclosed on the basis that it is not now possible to ascertain it.”

In other words, most of the costs of these titles were indeterminate internally generated ones. Thus, in 1998 (post FRS10), the Mirror Group Plc reversed its policy towards the capitalisation of certain titles, which it considered did not comply with the FRS10 requirement to provide a readily ascertainable market value. The Mirror Group Finance Director readily acknowledged in the report and accounts (1998, p25) that the accounting adjustment did not reflect any change in the directors’ opinion of the value of the Group’s titles but that the value was not to be capitalised. The overriding concern, therefore, was to avoid an audit qualification to the accounts through non-compliance with FRS10. In 1999 Trinity Plc had taken over the Mirror Group Plc to form Trinity Mirror Plc. It resulted in a huge increase in capitalised intangible assets of which £1,757m related to publishing rights and titles, and only £11m in respect of goodwill. The directors were of the opinion that the publishing rights and titles would have an indefinite economic life and, therefore, would not be subject to annual amortisation. It was confirmed to the author by Email that the previously capitalised internally generated “national and Scottish titles”, reversed above as part of the Mirror Group’s 1998 accounts, were disclosed again on the combined balance sheet of Trinity Mirror Plc. As these reversed titles were part of an acquisition for a complete business there was now a known transaction-based amount upon which to proceed with capitalisation or, more accurately, recapitalisation of those internally



generated publishing rights and titles. The representation of financial reality over this three-year period portrayed these titles as assets, pre FRS10. Then they were not assets, post FRS10. Then they were assets again on a different balance sheet. However, the important point is that each annual disclosure of financial reality was audit certified as being an accurate representation of the truth.

As we shall see in section 6.2.2, where the accounting rules are broken then power can be exercised to ensure compliant social action. However, as McBarnett and Whelan (1991, p873) state in contrast, “how do you control those playing by the rules?”. In the above Mirror Group Plc example the accounting actors played by the rules (a social structure) since the accounts all received audit approval. Yet, at the same time, that social structure presents a contestable portrayal of financial reality in respect of intangible assets. As Giddens (1984, p193) comments “...structural principles operate in terms of one another but yet also contravene each other.” Thus, whilst enforcing the accounting version of truth and fairness is a rule-driven matter, the dominance of that version may, paradoxically, be undermined by an application of the rules themselves. This last comment is particularly pertinent to purchased goodwill which, uniquely amongst intangible assets, is itself created from an accounting rule: a rule-driven “difference” and defined as such. And, like the above example, purchased goodwill may switch from non-asset status (pre FRS10) to asset status (post FRS10) according to the latest rule change and be audit approved in both cases as a true and fair representation of financial reality.

The issue of enforcement, per se, did not arise in the above case. Indeed, when we look at social action next we shall see how the power to effect compliance with the rules and principles of accounting occurs passively in most cases. In this regard, the findings of the

longitudinal survey, presented in appendix A, will be examined. However, we also need to address those minority situations where the power of the FRRP has to be applied to ‘direct’ compliance with the rules and principles of accounting.

#### **6.2.2. Cycle two: The power to exercise rule enforcement**

Domination occurs where widespread compliance with the rules of accounting is seen to occur in practice, such that the accompanying “true and fair view” audit opinions are equally widespread. It therefore follows that the FRRP does not need to direct rule compliance. In this regard, reference will be made to a longitudinal survey of accounting to assess the degree of compliance with the rules of accounting in respect of goodwill and intangible assets, pre and post FRS10. Only the findings will be discussed here in the first half of this section, the survey itself being attached as appendix A.

Domination also occurs where managements and auditors cannot agree on their representation of financial reality offered in a set of financial statements and their respective positions are referred to the FRRP for adjudication on what constitutes a true and fair view of it. The resolution of conflict that does not end up in Court is a positive indication to society of the existence of a responsible profession that is able to ‘keep its own house in order’. This point is addressed in the second half of this section.

#### *The summary findings of a longitudinal survey (see appendix A)*

The analysis presented in appendix A is presented in summary form, any detail being restricted to the central issue of purchased goodwill and brands since the latter is always extracted from purchased goodwill for capitalisation purposes. If the reader wishes to

explore all the intangible asset headings in the current survey then they are referred to Tollington (2002). The main findings were:

1. The compliant actions of accounting actors from 1998 onwards to the rules of accounting (FRS10) removed the need to direct and enforce compliance in all but a few cases. Whilst there were minor variations in accounting practice (see, for example, press notice PN52 later on), nevertheless, immediately post FRS10, all of the companies capitalised purchased goodwill and the overwhelming majority of them adopted systematic amortisation over goodwill's 'useful economic life', which was assumed to be 20 years or less. That said, more recently, there has been a small increase in the use of impairments, as well as, the usual amortisation charges in the notes of some company balance sheets.
2. There were eight technically insolvent companies in survey sample in 1997, that is, companies who were disclosing a negative 'capital and reserves' figure mainly due to the impact of the SSAP22 reserve write-off approach on the equity base of these companies. By 2002 this figure had been reduced to only six companies which is, perhaps, not surprising because the current rate of decline in the post-FRS10 cumulative goodwill write-off figures suggest that it will take at least another decade for the 'capital and reserves' base of the surveyed companies to be restored by write-backs on the disposal of purchased goodwill.
3. Relative to the sample size, brand asset accounting, which was assumed by many to be a way of minimising reserve depletion due to reserve write-offs, has remained 'small-scale' over the ten-year period (minimum 6, maximum 10 companies). The main initiators are still maintaining their 'separable recognition and disclosure' stance. They do so contrary to majority practice that subsumes brands within

purchased goodwill. This stance is audit approved because capitalisation is always on the basis of an extraction from purchased goodwill – a reliable measurement that remains part of the signification structure. The fact that these companies were able to exercise power contrary to the norms of the collectivity is an example of where the dialectic of control operates in favour of the subordinate. Even though FRS10 (ASB, 1997, para 12, p14) rules out such practices because of their unreliable measurements it would appear that, in the absence of an accounting standard specifically prohibiting their disclosure, such disclosures will continue. Unilever Plc, Reuters Plc and Allied Domecq Plc are relatively recent additions to this minority ‘club’ membership. Thus, in relation to cycle two, there have been few attempts to enforce the removal of brand disclosures from the financial statements where this disclosure is linked to purchased goodwill.

4. With the exception of the Vodafone Plc licence figure in 2001 (see appendix A), overall, the only major upheaval in practice was the capitalisation of goodwill arising from the implementation of FRS10. The survey suggests that purchased goodwill is set to become the dominant figure on many UK balance sheets.

### *Connective summary*

The central feature of the domination structure (in section 6.2.1.) was the contradiction of enforcing an audited, rule-driven, true and fair view of financial reality, that is, one that either excluded those ‘assets’ not complying with the rules of accounting or highlighted contradictions in the rules themselves (see also PN73 issued by the FRRP). The central feature of social action presented so far in this section (section 6.2.2) was, nevertheless, to show that compliance with the FRS10 rule was largely complete (the longitudinal survey, above). Yet, at the same time, there were also attempts to ‘bend those same rules’. This

was particularly so in respect of the separable capitalisation of brand assets and the related manipulation of reserves pre FRS10. However, the scope for arbitrage post FRS10 is now considerably reduced – a testimony to the power of the Board to shape and enforce a more consistent version of financial reality.

The explication of the social action of enforcement must also address the element of compulsion or force, that is, those cases where there is purportedly little or no compliance with the rules of accounting and a referral to the Financial Reporting Review Panel (FRRP) is necessary. The focus of social action is upon rule compliance despite the related contradictions raised in respect of the domination structure previously:

“This makes for a clearer line of enquiry during an investigation and allows the regulator to focus firmly on that which is in its powers to correct – the compliance of financial information with applicable reporting standards.” (FRRP1, p6)

Let us address that point next by reference to the FRRP press notices in Table 6.8.

The press notices only refer to those rulings in respect of the most notable companies and issues deemed to be worthy of explicit public exposure. The FRRP examines departures from accounting standards brought to its attention by auditors. The FRRP can agree revisions but the power to direct change would have to be enforced through the Courts. It is a power that has to date at the time of writing (2004) never been fully exercised probably because the cost of a referral to the Courts can be borne by the directors of a business personally if a revision is required to the accounts. Hence, the one case (PN13 Trafalgar House Plc) in Table 6.8 that went to Court was subsequently settled out of court.

<b>Table 6.8 FRRP Press Notices</b>							
<b>FRRP Press Notice No. and date</b>	<b>No case* to answer</b>	<b>Company revises** accounts</b>	<b>FRRP applies to court</b>	<b>FRRP Press Notice No. and date</b>	<b>No case* to answer</b>	<b>Company revises** accounts</b>	<b>FRRP applies to court</b>
1 (27 06 91)	N/A	N A	N/A	39 (09 04 96)		X	
2 (25 07 91)	N A	N A	N A	40 (01 05 96)		X	
3 (28 01 92)	N/A	N A	N/A	41 (30 05 96)		X	
4 (28/01 92)		X		42 (24 07 96)		X	
5 (28 01 92)		X		43 (02 10 96)		X	
6 (31/01/92)		X		44 (17 02 97)		X	
7 (04/02 92)	X			45 (15 04 97) <sup>++</sup>		X	
8 (08/07/92)	N/A	N/A	N A	46 (29 08 97)		X	
9 (10/08 92)	N/A	N/A	N/A	47 (02/10 97)		X	
10 (10/08/92)	X			48 (10/11/97)		X	
11 (10/08 92)	X			49 (25 02/98)		X	
12 (07/10 92)	X			50 (27/04 98)		X	
13 (15/10/92)			X	51 (12/05/98)	X		
14 (26/10/92)		X		52 (22/07/98) <sup>++</sup>		X	
15 (26/10 92)		X		53 (26/04/97)		X	
16 (22/02 93)		X		54 (02 09/98)		X	
17 (17/03/93)		X		55 (20/10/98)		X	
18 (01/04 93)		X		56 (24 02 99) <sup>++</sup>		X	
19 (05/04 93)	X			57 (29/10/99)		X	
20 (27/07/93)		X		58 (10/01/00) <sup>++</sup>		X	
21 (10/08 93)		X		59 (18/02/00)		X	
22 (24/09 93)		X		60 (24/02/00) <sup>++</sup>		X	
23 (27/09/93)	N/A	N/A	N/A	61 (11/07/00)		X	
24 (19/10/93)		X		62 (12/07/00)	N/A	N/A	N/A
25 (25/10 93) <sup>++</sup>		X		63 (18/10/00)		X	
26 (29/11/93)		X		64 (23/02/01) <sup>++</sup>		X	
27 (28/01 94)		X		65 (07/03/01)		X	
28 (11/02 94)	X			66 (11 04/01)	N/A	N/A	N/A
29 (24/05 94)		X		67 (04/07/01)		X	
30 (02/11/94)		X		68 (18/07/01)		X	
31 (23/11/94)		X		69 (28 08 01)		X	
32 (20/05 95)	X			70 (11 09/01)		X	
33 (21/06 95)		X		71 (26/09/01)		X	
34 (08 11 95)		X		72 (06 11/01)		X	
35 (13/12 95) <sup>++</sup>		X		73 (25 02 02) <sup>++</sup>	X		
36 (15/02 96)		X		74 (26/07/02) <sup>++</sup>		X	
37 (08 03 96)		X		75 (31 01 03)		X	
38 (28 03 960)		X		76 (14 02 03)		X	
				77 (05 05 04) <sup>++</sup>	N/A	N A	N A

**Key:**

N/A or not applicable refers to press notices on matters other than in respect of Panel rulings on the accounting practices of companies brought to its attention.

<sup>++</sup> Press notices relating to purchased goodwill, brands and other intangible assets.

\* The accounting practice is either accepted by the Panel or the issue can be waived or it falls outside the ambit of statute and accounting standards or the operating circumstance is sufficiently 'special' for the company to legitimately (according to the view of the Panel) invoke the true and fair view override (s227(4) Companies Act 1985). Such matters typically require a fuller explanation to be given in the subsequent accounts.

\*\* Revision is undertaken voluntarily by the company and relates to accounting practices that have not complied with the requirements of the Companies Acts or accounting standards (including UITF abstracts) including, in one case, where disclosure of the directors' actions concerning their own remuneration lacked transparency. No further action is undertaken by the FRRP.

Of the remaining seventy-six cases in Table 6.8, nine press notices were of a general nature, nine cases were dismissed and fifty-eight cases (the overwhelming majority of cases) involved a voluntary rectification of the accounts. The ‘after-the-event’ power to rectify accounts is an important enforcement mechanism. It invites the directors to ‘do the right thing’ and avoids the use of allocative and authoritative resources to compel change. As a result, the FRRP has urged the CESR to adopt the UK’s position of allowing directors to withdraw defective accounts, replacing them with ones of which the FRRP approves as being compliant with accounting standards. They argue that this action:

“...is one that the Panel would suggest that other member states may want to consider implementing. It is a means of ensuring that filed financial information complies with the relevant accounting requirements. By improving the reliability and integrity of the financial statements the action also serves to improve the confidence with which they are read by users” (FRRP1, p11).

The social actions of this body are consequently very effective in reinforcing the norms of behavior according to the latest rules of accounting. At the same time that social action reinforced the social structure posed by the FRRP as an acceptable organ of society fulfilling an important role that is perceived to be in the public interest. Otherwise, the State probably would not have considered expanding its societal role to be more proactive one in the future. Let us look at the press notices in more detail.

Press notice PN8 (11/06/92) referred to the fact that the FRRP had written to 240 listed companies over the previous year who had failed to comply with the Companies Act and accounting standards. PN23 (27/09/93) pointed out that 117 companies had been drawn to the FRRP’s attention since it issued its first press notice, PN1 (27/06/91), on working methods. They comprised those accounts that had been qualified or were non-compliant in some way (30), referrals by individuals and corporate bodies (49) and by press comment (38). The press notices are therefore the public ‘tip of an iceberg’ when one is viewing the

work of the FRRP. As a consequence, there is no way of guaranteeing that the press notices are representative of the totality of its pronouncements. In this latter regard the author had little success in getting further information from the FRRP or the companies themselves because of the reluctance to reveal confidential information.

The press notices that related to goodwill, brands and other intangibles were as follows: **PN25** (25/10/93) referred to the accounts of Ptarmigan Holdings Plc (now Graystone Plc) for the year ended 30 June 1992. It therefore predated FRS10, a time when the reserve write-off method of SSAP22 was the dominant approach to accounting for purchased goodwill. The company, however, wanted to switch to the strictly minority accounting treatment (but allowable under SSAP22) of capitalising goodwill, instead. The press notice stated:

“The company’s policy was to write-off goodwill arising on consolidation immediately to reserves in respect of all acquisitions. The policy was changed in the 1992 accounts to one which capitalised goodwill on acquisition and amortised it over its estimated useful economic life...However in the Panel’s view the reasons for the change had not been adequately disclosed in the accounts. SSAP22 permits the use of both capitalisation and immediate write off for different acquisitions in the same group but changes from one method to another must nevertheless comply with Companies Act requirements for a change of accounting policy.”

The change in accounting policy was allowed subject to the reasons being disclosed (in their 1993 accounts, name change to Graystone Plc):

“The policy now in force is a change in accounting policy. The special reasons for this change are that:

- (i) the Group fundamentally changed from the one that existed at June 1992 to a focused engineering group following the acquisition of the Component companies and Cableform. The previous businesses now form a relatively small part of the Group, and
- (ii) all businesses that were part of the Group at 30 June 1992, for which goodwill was recognised in the June 1992 accounts, have since been disposed of.”

It should be borne in mind that then dominant structure comprised a true and fair view that saw purchased goodwill as something to be written-off, not capitalised and amortised. The



allowable social action, sanctioned by the FRRP in this case, was contrary to the norms of the collectivity.

**PN35 (13/12/95)** where the company, Ferguson International Plc, was required to disclose gross goodwill and cumulative goodwill prior to the use of the share premium account – taking advantage of merger relief under section 131 of the Companies Act 1985.

**PN45 (15/04/97)** where the company, Reckitt & Colman Plc, was required to disclose additional information on a fair valuation exercise that included purchased goodwill

**PN52 (22/07/98)** where the company, Reuters Holdings Plc, in adopting FRS10 early, amortised goodwill below the line (to reserves) rather than, as the FRRP preferred, above the line (to P&L expenses) as part of their operating charges. Consider the following published account extract which summarises the issue - Figure 6.6:

<b>Figure 6.6 Reuters Plc Balance Sheet</b>		1997	1996
	Notes	£m	£m
Fixed assets			
Intangible assets: Goodwill	16	157	198
Tangible assets	17	816	775
Investments	18	73	53
		1,046	1,026
Note 16 – Intangible Assets:		Cost	Amortisation
Goodwill			NBV
		£m	£m
31 December 1996		464	(266)
Additions		10	-
Amortisation charged in year		-	(51)
31 December 1997		474	(317)
<b>Prior year adjustment:</b> In 1997 the UK Accounting Standards Board issued Financial Reporting Standard 10 Goodwill and Intangible assets. Reuters has implemented this Standard which requires purchased goodwill and intangible assets to be capitalised and amortised through the profit and loss account over their useful economic lives. All goodwill previously eliminated against reserves has been reinstated as an asset on the balance sheet by way of prior year adjustment and cumulative amortisation as at 31 December 1994 has been written-off against the brought forward profit and loss account reserves at that date.			

Reuters agreed to make the necessary amendment in their 1998 accounts by way of prior year adjustment in the P&L account. A year earlier in 1996 there was no disclosure of intangible assets on the face of the balance sheet, goodwill being written off to a negative “goodwill elimination reserve.” The first line of note 16 above shows the restatement of that reserve in 1997 as an asset instead (Credit Reserves, Debit Intangible Assets). Reuters Plc was one of the few companies to comply early with FRS10 in 1997 rather than 1998. Additionally, Reuters Plc was one of the few companies who chose to capitalise all purchased goodwill previously written-off to reserves (the £464m in note 16 above). Most companies chose to capitalise/amortise goodwill post FRS10 only. Perhaps, the size of the resultant amortisation charge had some bearing on the decision to amortise £176m of the above £266m (see note 16 again) ‘below the line’ to reserves. The £176m relates to the “...cumulative amortisation as at 31 December 1994...” which in Figure 6.6 is referred to as the “prior year adjustment” note. Another point to note here was the variability in the transitional arrangements that allowed previous goodwill write-offs to either remain written-off or to be capitalised. The resultant ‘true and fair view’, approved of by the auditors as being compliant with the FRS10 transitional arrangements, nevertheless, could result in a seriously distorted picture vis-à-vis other sector company accounts depending on the policy choice adopted by each company.

**PN56 (24/02/99)** where the company, AIM Group Plc, was required, per FRS7, to remove provisions for reorganisation and integration costs from a fair valuation exercise thus affecting the size of the remaining purchased goodwill balance.

**PN58 (10/01/00)** where the company, PWS Holdings Plc, was required to relocate an amortisation charge in the P&L account – similar to the Reuters case.

**PN60 (24/02/00)** refers to Sinclair Montrose Healthcare Plc where the company wrongly sought to use SSAP13 on Research and Development to capitalise its Medicare brand as a development cost.

**PN64 (23/02/01)** referred to the accounts of Artisan Plc for the year ended 31 March 2000.

A rule change from the SSAP22 elimination approach to the FRS10 capitalisation approach resulted in a diametrically opposed version of financial reality for the same goodwill 'asset' and the question arose as to which version, pre-rule change or post-rule change, offered the 'truer and fairer' view of it. The company was therefore expected to comply with the requirement to capitalise goodwill per FRS10 (ASB, 1997) and not with the write-off approach under SSAP22, now withdrawn:

"The Financial Reporting Review Panel...had under consideration the Report and Accounts of Artisan (UK) Plc for the year ended 31 March 2000 and has discussed them with the company's directors. The main matter at issue was the company's accounting treatment of purchased goodwill. Financial Reporting Standard (FRS) 10 'Goodwill and Intangible Assets' requires that positive purchased goodwill is capitalised and classified as an asset on the balance sheet (paragraph 7). Where it is regarded as having a limited useful life, it should be amortised on a systematic basis over that life (paragraph 15). The company's stated accounting policy in respect of goodwill was in compliance with these requirements. However, of the £10.4 million goodwill arising on businesses acquired during the year, £7.4 million was written off to the company's merger reserve. This treatment was not consistent with the company's stated accounting policy and is contrary to the provisions of FRS10 as noted above...The directors have accepted the Panel's findings and, in their March 2001 accounts, will be correcting the accounting treatment of purchased goodwill in the 2000 accounts by way of prior year adjustment."

In response to the FRRP, in note 2 of Artisan plc's 2000/01 accounts (p24), the following statement was made:

"As announced on 23 February 2001, following a review by the Financial Reporting Review Panel, the directors now consider that it was inappropriate, in the accounts for the year ended 31 March 2000, to write off the goodwill of £7,397,097 arising on the acquisition of Bickerton Group plc and investment in Heritage plc to the merger reserve arising in respect of that acquisition. The directors believe that their stated policy in respect of goodwill should have been applied, and accordingly have now restated the accounts so

as to capitalise this goodwill with effect from the effective date of acquisition of 30 March 2000 and amortise it over their estimate of its useful life of twenty years. The effect of this restatement is to increase net assets and shareholder funds at 31 March 2000. The restatement has no effect on the results for the year then ended.”

One may reasonably conclude that compliance with the rules of accounting was the driving force behind the FRRP’s decision. The fact that the goodwill accounting rule had switched from being ‘non-asset’ disclosure under SSAP22 to ‘asset’ disclosure under FRS10 was irrelevant to the fact that Artisan (UK) Plc wanted to adopt the opposite approach to the established accounting rule: FRS10. Thus, a “true and fair view” may be interpreted as compliance with the rules of accounting irrespective of the conceptually questionable effect of a change from non-asset to asset at least for disclosure purposes. The enforcement cycle of social action reinforcing the social structure posed by accounting rules operated effectively in this case to ensure compliance but, at the same time, it raised doubts at a conceptual level of enquiry about whether such contradictions could be said to offer a true and fair view of financial reality.

PN73 (25/02/02) is addressed later on.

PN74 (26/07/02) referred to the accounts of Equator Group Plc for the year ended June 1999. The case involved the revaluation of film rights, which had initially been capitalised on the basis of their readily ascertainable market values (RAMV) and were to be subject to impairment reviews. The individual revaluations of these film rights upon acquisition cumulatively gave rise to a negative goodwill figure on the balance sheet. However, the Panel viewed each film as unique, also, any reference to the market value could not be viewed as being an active one in accordance with FRS10. Hence, any revaluation could

not exceed an amount greater than the cost of the acquisition (paragraph 45, FRS10), also, the rebuttable presumption of a twenty-year life was applicable.

Finally, PN77 (05/05/04) did not refer to a specific case. Instead, it gave some guidance on FRS10 paragraphs 58 and 59, the sections dealing with the rebuttable presumption of a twenty year life which, if rebutted, should be explained in sufficient detail to justify the use of the ‘true and fair view’ override. They had found that in a number of cases (PN74 perhaps being one of them) little or no reasoned explanation had been given for a rebuttal.

Let us now address the third element of Figure 6.5, the use of resources.

### **6.3.3 Cycle two: The use of resources**

The allocative resources at the FRRP’s disposal are drawn from its own diverse funding arrangements between the accountancy bodies, the Stock Exchange, other City institutions and the DTI. Over the years, part of those resources have been set aside in the form of a permanent ‘fighting fund’ of approximately 3 million euros in order to pursue companies in court should they fail to comply with the directions of the FRRP. This fighting fund is also a way of ensuring the independence of the FRRP from those companies who may be in conflict with the FRRP whilst, at the same time, being one of its financial contributors. The interesting feature about these resources is that they have never been used – see Table 6.8 again. It would appear that there is something about the authoritative resources at the FRRP’s disposal that renders as redundant the use of any related allocative resource. The possible use of the fighting fund therefore remains as a threat that, so far, has not been actualised - an example of the exercise of passive power.

It should be understood that the possible application of the FRRP's allocative resources to enforce social action is not about punishing error for two reasons. First, it is the social construction that would be enforced and not the social actor. Second, the domination structure in cycle one is primarily directed towards establishing a true and fair view, rather than towards those who would wilfully offer an untrue and an unfair view of financial reality. It is argued that the power to punish, whether applied or not, is actually a resource which operates passively most of the time. Resource mobilisation to complete the recursive rule enforcement cycle (see Figure 6.5) between social structure (section 6.2.1) and social action (section 6.2.2) therefore tends to be mainly of an authoritative nature.

An interesting dialectic is whether the exercise of the FRRP's authority to direct compliance with its rulings is directed towards social structure (the pursuit of a true and fair view – a virtual construction) or social action? (ensuring that company directors comply with the accounting rules). The dialectic is interesting for two reasons. First, we know from the comments by the FRRP itself in the previous section that the use of authoritative resources is directed primarily towards the company's directors since they are responsible for the corporate entity. Likewise, the FRRP's ruling will be directed towards the directors in the expectation that their ruling will be carried into effect (a social action). However, these rulings, whilst authoritative, do not possess the element of force, that is, the FRRP cannot apply allocative resources to enforce its will because there is no structural basis to do so. The structural basis actually rests with the Courts – to be addressed in the next paragraph. Secondly, the social action of rules (plural) compliance can sometimes conflict with each other such that the domination structure is capable of multiple, yet equally legitimate interpretation. Under such circumstances, the FRRP has to

apply its authority to create what it subjectively regards as the best representation of accounting 'truth and fairness'. This point is illuminated by reference to PN73, later.

Let us return to the first point in the previous paragraph. Prior to the point where legal action is to be applied to enforce an FRRP ruling, a distinction between corporate power and individual power is maintained. To repeat, it is the social construction that would be enforced and not the social actor. Thus, the rectification of company accounts that occurs in most cases is directed towards the corporate entity. However, if the FRRP does decide to enforce its authority by reference to the courts and wins the case, then, under s245b of the Companies Act 1985 the directors are personally, not corporately, liable for the costs of the case. This switch from corporate liability to personal liability is highly likely to be the reason why, to date, no FRRP ruling has ever been challenged in court. Section 245b is therefore a very powerful authoritative resource. When combined with the access to the fighting fund, both resources end up being a passive, yet highly effective means of enforcing the rulings of the FRRP.

There is an assumption here that the cycle presented in Figure 6.5 is a positively reinforcing one, that is, regardless of whether the element of compulsion is applied under s245b or not. In other words, the domination structure remains uncontested by the consequences of social action. However, there was one notable example, PN73, where the domination structure was contested. In this case the company sought to rely on one rule, the true and fair view override (s227(6)CA85), to override another rule (para49, FRS10) in respect of negative goodwill arising from an increased share holding in a subsidiary company. This latter stance was contrary to the wishes of the auditors. The company had applied FRS2 on *Accounting for Subsidiary Undertakings* but then declined to apply

FRS10 despite the linkage between them in respect of goodwill. Thus, there was also a potential conflict between FRS2 and FR10 in respect of that linkage. The FRRP applied its authority to uphold the use of FRS2 but not FRS10. Thus, the company's use of the true and fair view was justified in the 'special circumstances' of this case. The above example refers to the FRRP's power to direct, despite the conflict of rules, what will constitute the dominant constructed version of financial reality and to apply resources to that effect.

Let us finally turn to the outcomes from cycle one and cycle two in section 6.3.

### **6.3. A summary and analysis of the recursive cycles one and two and the outcomes from them**

Figures 6.2 and 6.4 show outcomes from the recursive cycles concerning rule creation (section 6.1) and rule enforcement (section 6.2), respectively. Those outcomes are addressed here (section 6.3) but first, it is necessary to summarise these cycles so that the outcomes are grounded on the analysis presented in this chapter.

#### **6.3.1. The outcomes from cycle one.**

Methods A, B and C were asset-based methods for which there was, respectively,  $33\%+17\%+9\% = 59\%$  support from the respondents to the discussion paper. The largest support (33%) amongst the respondents was for the method A 'capitalise and amortise' approach. Further, a negative 'separate write-off reserve' (method E – a positive debit presented as a negative credit that *remains on the balance sheet*) could be said to be asset-based too even though it was presented by the Board as an elimination-based method. There was 30% support for this method. The two dominant methods A (33%) and E (30%) should have the two recommended approaches taken forward into the working paper if majority-based consensus building was the Board's objective. Instead, methods C (9%)



and E (30%) were chosen, minority method C being the hybrid ‘capitalise/amortise and/or capitalise/impairment’ approach. Despite the lack of support for impairment, whether individually (method B, 17%) or as part of this dual track approach (method C, 9%), the Board was determined to integrate impairment into the consultation process and ultimately into FRS10. Since, impairment is only related to asset-based methods, it is reasonable to present the following

*Outcome 1 (Box D, Figure 6.2): Consultation is about trying to achieve a consensus viewpoint but that viewpoint does not necessarily dominate. The power to dominate policy is predominantly held by the Board and it chose to be guided as much by the internationally dominant capitalisation stance as it did by the views of the national collectivity.*

The above assessment suggests that the Board was predisposed towards asset-based approaches from the outset of the consultation process with the national collectivity. It was therefore surprising that, whilst the Board could have claimed majority support amongst the respondents to this stance (59%), its own analysis of those responses did not reveal it. In addition to a domination structure driven by international developments, the Board’s stance was also underpinned by national concerns about reserve depletion and accounting arbitrage making the international stance a more attractive one to adopt anyway.

Two competing coalitions were shown to be present: one which, following consultation with the national collectivity, dismissed impairment (the respondents’ stance) and one which, motivated by developments at the international level, supported the use of impairment (the Board’s stance). Therefore, any social structure arising from the construction of a dominant coalition towards the use of a single accounting method was unlikely to occur. The resultant social structure ran the risk of being undermined in a

similar manner to SSAP16 in the early 1980s. As a consequence, FRS10 allowed accounting actors to choose either, or both, amortisation and impairment (a hybrid approach) providing purchased goodwill was capitalised in line with international developments.

*Outcome 2 (Box D, Figure 6.2): This hybrid policy decision by the Board allowed accounting actors to acquiesce in their acceptance of two accounting methods knowing that, for many of them, they would adopt only one method in practice. The decision, nationally, to 'push through' impairment reviews in FRS10 and then shortly afterwards in FRS11 indicated some foreknowledge of an international agenda which the Board was determined to follow.*

Notwithstanding the international developments, the Board trod a tightrope between international compliance on one hand and keeping the national collectivity 'on board' during a period of consultation and change. This does not mean that consultation and any related decision making by the Board had to be on the basis of a consensus, otherwise impairment would have been rejected, but it does mean that a degree of compromise was necessary – the two methods presented in FRS10. Why? Because the power of the Board would be diminished where it was evident that the accounting collectivity was openly hostile to regulatory change. In offering two accounting methods the Board effectively neutered the collectivity's opposition to impairment. For instance, the overall impression of the responses to FRED12 spoke of a collectivity that was reluctantly prepared to accept the compromise ultimately presented in FRS10 for the sake of bringing closure to the debate.

Finally, there was very little attempt to ground the consultation process on the content of the signification structure of which the definition of an asset is part. Thus, whilst many respondents expressed conceptually based doubts about the asset status of goodwill, the operating nature of the definition of an asset did not assist in differentiating an asset from an expense. But, in one sense, this did matter because it was not part of the goodwill debate anyway as initially presented by the Board. In fact, the starting point in the discussion paper (ASB, 1993) was the presentation of six pre-selected technical accounting methods. An alternative conceptually based starting point could have to ask whether goodwill was an asset or not and, if not, then clearly all asset based approaches such as those outlined above would have been rejected and vice versa regarding elimination based methods. Thus,

*Outcome 3 (Box D, Figure 6.2): The power of the Board to direct the technical content of the debate, at the same time, resulted in closure on conceptual issues that could have raised challenges to the signification structure itself – a potentially never-ending debate.*

One such instance related to the separable disclosure of intangible assets, other than purchased goodwill, where the Board cleverly allowed disclosure to take place, subject to strict ‘transactions-based’ conditions based on readily ascertainable market values, without undermining the signification structure through a greater use of unsubstantiated valuation-based approaches.

### **6.3.2. The outcomes from cycle two.**

The process of enforcement is generally predicated on the basis that one true and fair version of financial reality should dominate, the one that reflects compliance with the rules of accounting according to the auditors understanding of compliance. Indeed, the results of a longitudinal survey of accounting practices showed:

*Outcome 4 (Box D, Figure 6.4) In the vast majority of cases there was compliance with FRS10 in respect of the capitalisation of purchased goodwill – de facto domination, which was audit approved and thus removed the need for enforcement.*

One may argue that the new rule of capitalisation (FRS10) is better than the old rule of elimination (SSAP22) because the scope for accounting arbitrage has been reduced considerably. Yet, those same rules allow structurally-based contradictions to exist that undermine a domination structure centred upon the pursuit of a true and fair view of financial reality. To repeat the McBarnett and Whelan (1991, p873) comment: “New rules simply means new games” to play as the an example presented in section 6.2.1 illustrated.

The interesting feature of the cycle two domination structure is that the ‘transaction cost versus valuations’ tension inherent to the signification structure is respectively mirrored in the ‘legalistic versus economic’ tension inherent to the accounting perception of a true and fair view. Whilst, in both cases, the legalistic/transactions-based stance dominates, ultimately its dominance is grounded on an opinion of the truth and fairness of the resultant social construction in the domain of financial reporting: a certificated audit opinion in the first instance. Where this fails, a second opinion is obtained from the FRRP which, as we saw in respect of PN73, can override other opinions as to the extent of compliance with the rules of accounting where this is subjectively perceived to offer a truer and fairer view of financial reality. These opinions can ultimately be tested in Court under s245b CA85 but this does not happen for the reasons outlined in section 6.2.3. One may reasonably conclude in

*Outcome 5 (Box D, Figure 6.4) that the accounting profession possesses a formidable power to shape financial reality according to its own rules and opinions on the truth and fairness of the resultant social construction. That social construction is ultimately*

*protected from challenges to its authenticity (alternative opinions) by the existence of an equally formidable resource: the fighting fund and s245b CA85, even though this allocative and authoritative resource is seldom, if ever, used in practice.*

## **Chapter Seven – Summary and conclusions**

### **7.0. Introduction**

Using Giddens's structuration theory, the social structure in respect of accounting for goodwill and intangible assets and the social action of respondents to that structure has been explicated. The interaction of social structure and social action was conducted at the level of:

- (a) Signification: The linkage between the signification structure and the communication of meaning in the accounting disclosure of goodwill and intangible assets was determined by interpretive schemes of which the reliability of transactions-based measurement remains the principal feature.
- (b) Legitimation: The linkage between the legitimation structure and the sanctioning of social action is determined by norms of behaviour of which the moral obligations to act in the public interest, to act professionally, to rationalise practice according to a conceptual schema and to ensure regulatory compliance are the principle features.
- (c) Domination: The linkage between the domination structure and the power to affect social action was determined by the use of resources. Those resources were directed towards a selective construction and enforcement of a true and fair view of financial reality according to international norms.

The purpose here is to establish some outcomes and conclusions from the above use of structuration theory in order to answer the following central research question:

*How did the Accounting Standards Board resolve the conflicting views of the respondents to the Board's standard-setting consultation process prior to producing FRS10?. In particular, how the Accounting Standards Board construct and perpetuate a portrayal of financial reality that currently includes 'purchased' goodwill and, at the same time,*

*excludes many other intangible assets in opposition to those parties who argued the case for their inclusion on the balance sheet?*

The dimensions of structuration were first presented in terms of individual recursive cycles in chapters four (signification), five (legitimation) and six (domination). They are presented together in the three columns of boxes in Figure 7.1.

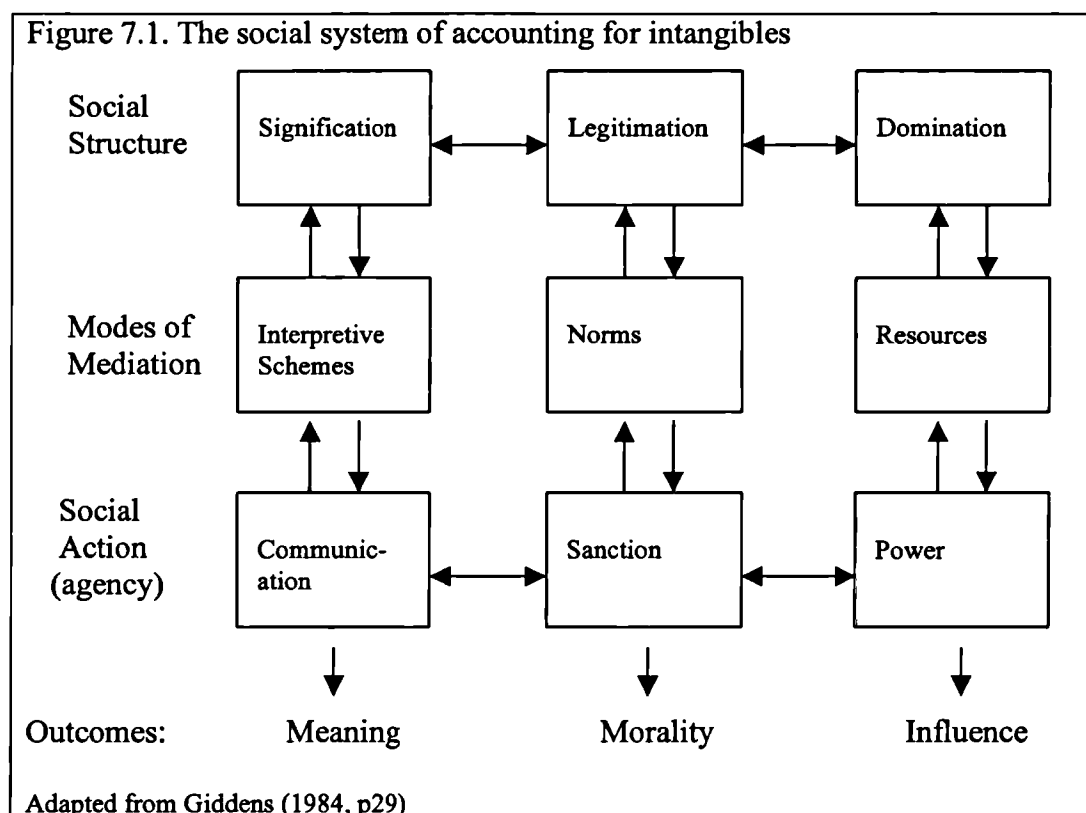


Figure 7.1 highlights the ‘duality of structure’, that is, where social structure (first row) is both the medium and the outcome of social action and interaction (third row) as mediated by the ‘modes of mediation’ between them (second row). This duality is to be reviewed and analysed in respect of the dimensions of signification, legitimation and domination in sections 7.1 to 7.3, respectively. The overall position is then assessed in Section 7.4 with a view to establishing the nature of the links between the three dimensions of structuration theory at the level of social structure (first row) and at the level of social action (third row) – hence the lateral double-headed arrows between the columns in Figure 7.1. Section 7.5

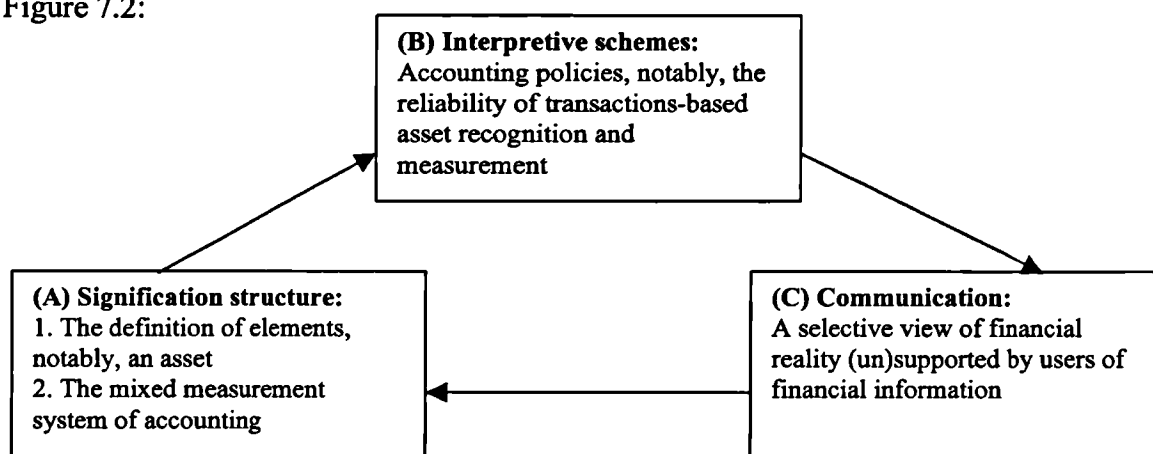
addresses the limitations of this study. Finally, some pointers are given in Section 7.6 as to the future direction of research in this area.

## 7.1. Signification

The recursive elements of signification are repeated in Figure 7.2 (same as Figure 4.2).

Figure 7.2 links to the first column of boxes in Figure 7.1.

Figure 7.2:



### 7.1.1 Signification structure

Let us first address the signification structure (Box A, Figure 7.2), the detail of which was portrayed in Figure 4.3(a)&(b) and discussed extensively in section 4.1. The two principal features of this structure are portrayed in Figure 7.2, above. These two features may be summarised in the following terms:

First, attempts at boundary setting between an asset and an expense resulted in primacy being given to the definition of an asset and with it the implied primacy of the balance sheet. The accounting nature of an asset is a defined nature as presented in the *Statement of Principles* (ASB, 1995b, p53;1999, p50) and, therefore, the balance sheet representation is a defined reality in that regard. However, that defined nature is, almost paradoxically,



measurement focused, that is, upon the measurement of future economic benefits.

Therefore, it does not actually assist in recognising the nature of an asset or by exception, an expense or, indeed, in demarcating the boundary between them. As such, the existing signification structure presupposes the measurement of the elements (assets, expenses, etc.) as the basis for recognition, the subsequent categorisation as an asset or an expense being at the discretion of accounting actors.

Second, there is an in-built tension between transactions-based cost that dominates at the initial recognition stage of an asset and the use of fair values because their use introduces mixed measurements into accounting. This tension is not so much a problem with the operation of the signification structure (mixed measurements have been around for some time!), rather, it has to do with whether that structure serves the interests of actors when non-transactions-based or internally generated intangible assets are excluded from it. This is because it is possible to arrive at a fair value many of intangible assets independently of the recognition boundary created by “past transactions or events”, per the definition of an asset (ASB, 1995b, p53; 1999, p50) and this is the cause of much of the tension over the signification structure (see Figure 4.3(a)).

**Conclusion One:** The measurement of the ‘asset’ element within the signification structure dominates to the point where measurement, on whatever bases, is the means for asset recognition, or not, at the discretion of the accounting actors. The signification structure is measurement focused and not recognition focused, that is, according to the nature of those elements: assets and expenses. That nature has not been articulated in terms of recognition criteria or any other basis, only in terms of a definition which itself is not only measurement focused on “future economic benefits” but is also one which accommodates multiple measurement bases.

Let us return to Figure 4.3(a)&(b) to explore the above two principal features of the signification structure in summary – relabelled here as Figure 7.3(a)&(b).

The choice of a single measurement basis would prejudice one's view of the financial statements: transactions-based cost plus matching favouring the profit and loss account, a valuations-based approach favouring the balance sheet. However, the policy choice in the signification structure (Figure 7.3, Box G) was not expressed in terms of a choice over measurement bases. Rather, to repeat, it was expressed as a choice over the primacy of the definition of an asset (Figure 7.3, Box I) and with it the primacy of the balance sheet (Figure 7.3, Box E). Whilst this policy choice favours the use of valuations, so called fair values (Figure 7.3, Box D as a logical compliment to the choice of Box E), the transactions-based asset recognition trigger dominates in practice and with it the preference for the recording of transactions-based cost (Figure 7.3, Box B). An example to that effect was shown in section 6.2.1. However, the tension over the choice of cost or value in any given situation often does not necessarily need to be addressed within a structure that allows both measurement bases to exist at the same time.

Whilst the use of mixed measurements may be an unaddressed source of tension at the level of signification, it is also a specific problem concerning one very important intangible asset: purchased goodwill. The definition of purchased goodwill is explicitly expressed as a "difference" between two measurement basis: the acquisition cost (Figure 7.3, Box B) and the fair value of the acquired assets (Figure 7.3, Box D). In other words, the tension reflected in the signification structure is mirrored, at the micro level, in purchase goodwill itself.

Figure 7.3a:  
The Signification Structure

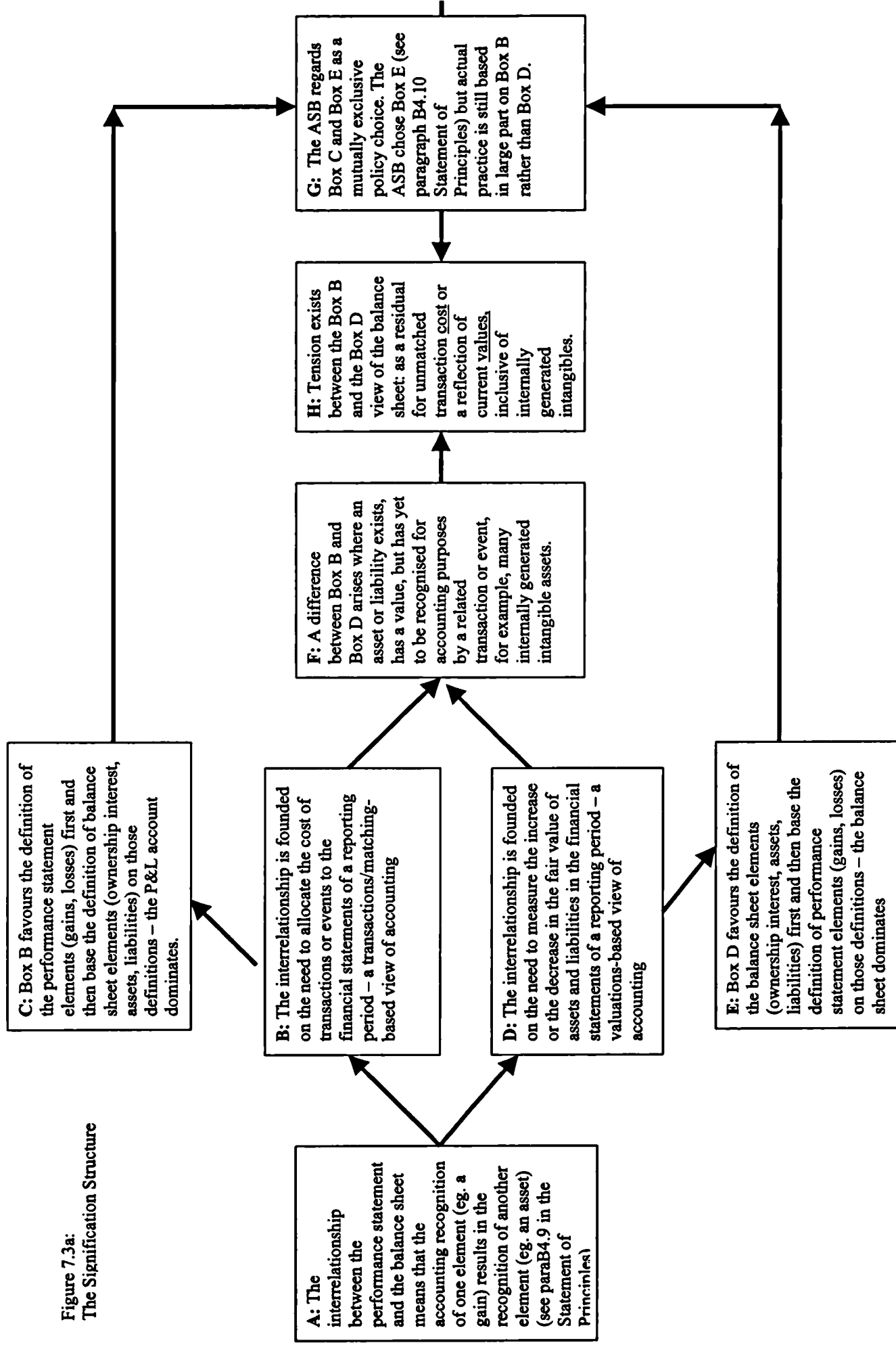
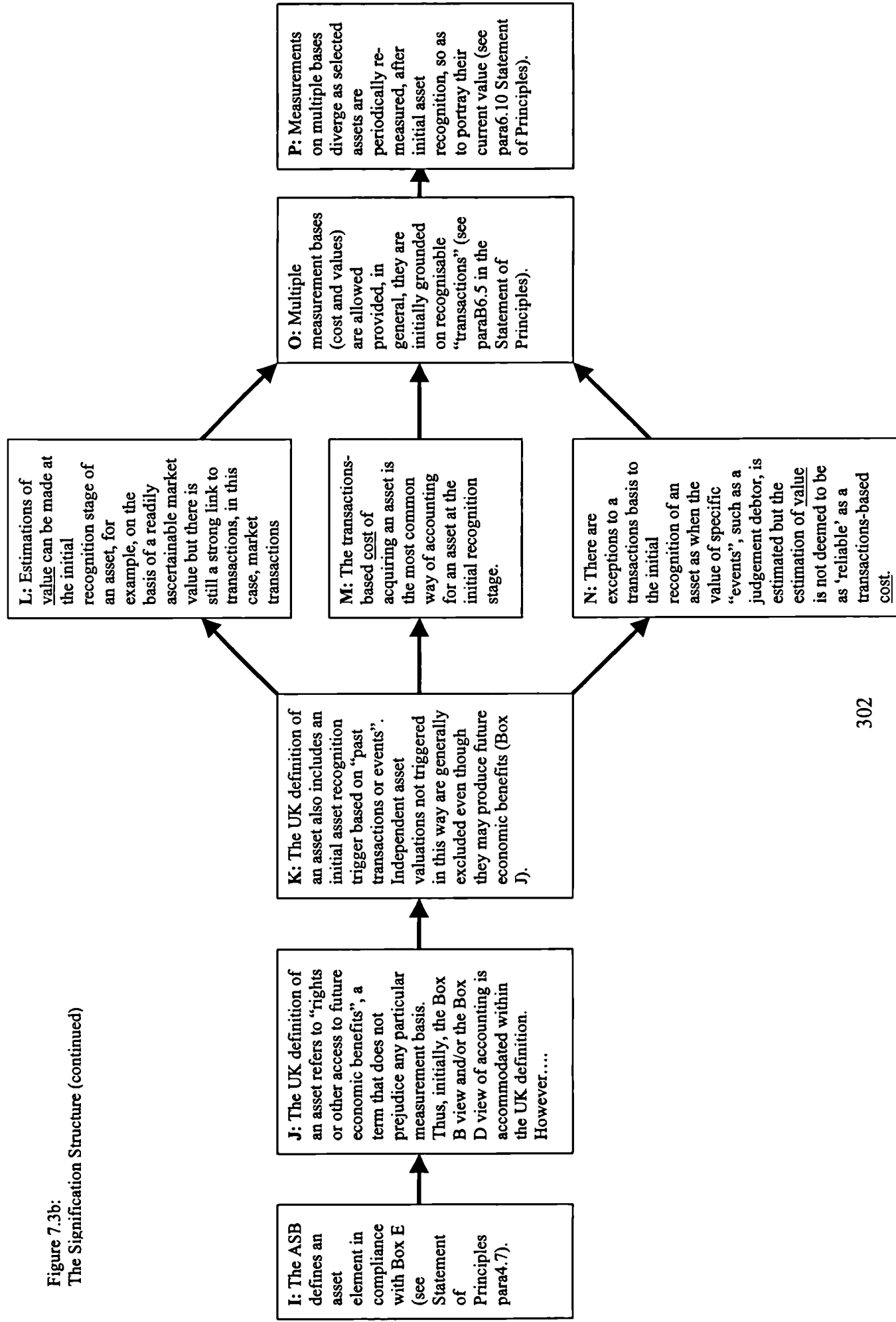


Figure 7.3b:  
The Signification Structure (continued)



Thus removing the tension at the macro level, that is, through the adoption a single measurement basis within the signification structure, would also remove purchased goodwill itself.

**Conclusion Two:** A single measurement basis in accounting, for example, original cost, would remove purchased goodwill at one stroke because the cost of the business acquisition would reflect the cost of the assets acquired, as opposed to the purchased goodwill “difference” in the current definition reflecting the cost of the business acquisition and the fair value of the assets acquired. Thus, with a single measurement basis there is no measured “difference” and, therefore, no purchased goodwill “difference”.

Obviously, where the cost reflects a premium to acquire a business the allocation of that premium to individual assets may consequently reflect an element of overpayment vis-à-vis their current market values. The premium or overpayment aspect, depending on your viewpoint, may be reflected in terms of the subsequent amortisation or write-off policy but this is a separate point from the elimination of the measurement “difference” that is the defined nature of purchased goodwill. Equally, it is axiomatic that the allocation of some of the purchase cost to, as yet, unidentifiable intangible assets will be highly problematic. However, first, this is an issue of recognition and not of measurement, second, it is a demarcation problem between what should be regarded as an asset or an expense for accounting purposes.

### **7.1.2. Interpretive Scheme**

Let us return to Figure 7.2 and summarise the content of box B. The key interpretive scheme in respect of intangible asset disclosure is the requirement for reliability of measurement as afforded by transactions-based measurements.

An alternative measurement basis to transactions, as presented in Figure 7.3(a)&(b), is one based on asset valuations independently of transactions. However, there is no fixed

reference point (item, date and usually, the amount) by which to judge a value as there is with a transaction or with a specific event. As a consequence, valuations are deemed to be unreliable measures unless they are linked to transactions in some way. Hence, it was the application of this interpretive scheme that, for example, saw the reversal of United Biscuits Plc's capitalised brand valuations, the reversal of the capitalisation of Mirror Group Plc's Scottish newspaper title values and a restatement back to cost of Ladbroke Plc's betting licence values in 1998, all immediately post FRS10 – see section 6.2.1. However, by comparison, many would argue that with the passage of time transaction-based costs become equally unreliable in terms of their portrayal of current economic reality. Thus,

**Conclusion Three:** 'Reliability' of measurement, whether transactions-based or valuations-based, is essentially a subjective assessment. At the moment, the related accounting interpretation is generally to preclude the use of independent valuations at the initial recognition stage of an asset.

That said, there is nothing to stop the accounting profession from regulating valuations-based initial asset recognition into existence if it chose to do so. As a result we have here a political struggle in which social interaction takes centre-stage, notably between accounting standard setters and those affected by their pronouncements.

### **7.1.3 Communication**

Finally in this section let us return to Figure 7.2 and summarise the content of box C.

The consultation (and communication) process leading up to the implementation of FRS10 may be viewed as a process that ultimately attempts to convert reflexivity at the discursive level of consciousness into one that becomes practical, that is, actors eventually relying on implicit stocks of knowledge about how to behave and respond to others in a social setting.

Conversion occurs where there is closure on the debate and actors begin to routinely access the stock of knowledge, in this case, FRS10. This conversion process supposes that actors have a shared understanding of the meanings conveyed by the signification structure and any regulatory change occurring within its ambit. The examples in respect of United Biscuits Pl, Mirror Group Plc and Ladbroke Plc, above, are testimony to compliance with regulatory change, compliance that actually enhances the transactions-based signification structure. However, as the dialectic of control showed, compliance does not necessarily mean acceptance, which was certainly the case in respect of the respondents views as discussed below.

Many respondents, in section 4.3.1, identified that the tension (Figure 7.3, Box H) at the heart of the signification structure was the root cause for the non-disclosure of internally generated intangible assets. That tension may be summarised as the respective tension between the reliability, but decreasing relevance of transactions-based cost versus the greater relevance, but less reliable measurement associated with a valuations-based approach. A full valuations-based approach to accounting would, in principle, make no distinction between whether an identified asset was purchased (transactions-based) or not. And, the reason for not moving towards a full valuations approach to accounting (explored in section 4.3.2), with or without transactions, was the issue of the unreliability of measurement associated with that approach (conclusion three, above). There may be some discretion to do otherwise but in practice social action and social structure reinforce each other in asserting the dominance of transactions. Indeed, although RAMVs (readily ascertainable market values) broadened the scope of the signification structure and gave the impression of a relaxation to it, in practice the linkage to transactions-based recognition was if anything strengthened by its inclusion in FRS10.

Some respondents avoided the tension at the heart of the signification structure by maintaining the SSAP22 reserve write-off approach to accounting for intangibles. There was consistency (but not comparability at the international level) in this approach because internally generated and purchased intangibles were expensed, albeit ‘below the line’ to reserves rather than ‘above the line’ as a P&L expense. Yet, there were a few respondents who thought that intangible assets should be expensed above the line. The approach was humorously dismissed by the Board as being the ‘biggest of baths’ and was not even advanced as a possible accounting option in the discussion paper, despite being a ‘reliable’ approach inside the signification structure. One suspects that part of the reason for this response was that it negated a contrary predisposition of the Board towards asset-based approaches and both perpetuated (below the line) and enhanced (above the line) the respective problem of historic and current profit depletion. The only accommodation to the write-off lobby was the possibility of disclosing a separate-off reserve which, in effect was a positive debit asset masquerading as a negative liability or negative reserve – a bizarre concept and representation that allowed goodwill to remain visible on the balance sheet.

**Conclusion Four:**

The SSAP22 immediate reserve write-off approach to accounting for goodwill and intangible assets avoided the tension raised by the use of mixed measurement because the mixed measurement difference, de facto, ceased to exist (partly complimentary to conclusion two, above). From the outset, the framework for consultation was both structured and steered towards the Board’s predisposition for asset-based approaches to goodwill and intangible assets.

*7.1.4. Summarising in relation to the central research question*

Let us return to Figure 7.2 and the middle part of the central research question: “... a portrayal of financial reality that currently includes ‘purchased’ goodwill and, at the same time, excludes many other intangible assets...” from the balance sheet.



Implicit to the assertion of many intangible assets being excluded from the balance sheet is the assumption that purchased goodwill and intangible assets and their non-transactions-based internally generated counterparts are both part of the asset element for accounting purposes. Indeed, the tension portrayed by Boxes F and H in Figure 7.3a is predicated on the basis that non-transactions-based assets exist and that they fall outside the ambit of the signification structure and, ultimately, disclosure on the balance sheet. The counter-argument is that if internally generated goodwill and intangible assets were expensed instead and recognised as such for accounting purposes, then there would be no inconsistency in accounting practice or related ‘tension’. The only inconsistency would be in the discretion of accounting actors to selectively recognise and categorise the transactions-based measurement as an asset element or as an expense element. However, such a viewpoint remains within the signification structure, one which, as portrayed in conclusions one, two, three and four above, is focused on the issue of transactions-based asset measurement.

Conclusions one and three positively reinforce the recursive cycle presented in Figure 7.2. Conclusion four is an ‘avoidance tactic’: the two principal features of the signification structure (Box A, Figure 7.2) are irrelevant if the expenditure in question is written off. However, conclusion two presents an inherent contradiction which risks undermining the signification structure itself. Let us explore that issue further.

The “inherent contradiction” of purchased goodwill relates to the issue of asset recognition according to its nature and not just according to its measurement. The truth is that no one knows what the purchased goodwill measurement bases “difference” actually represents by nature. The nature of purchased goodwill is not articulated other than as a measured

“difference” and defined as such. No other ‘asset’ is defined in this way, if it is one in the first place? Thus, within a measurement focused signification structure purchased goodwill may be regarded as an asset because it is transactions-based, per the definition of an asset, and capable of reliable measurement albeit as a mixed measurement “difference” (see Boxes A and B, Figure 7.2). These are sufficient grounds for the ASB, post FRS10, to support its disclosure on the balance sheet: a revised communication of financial reality (Box C, Figure 7.2). Thus, the avoidance tactic raised in conclusion four is now itself avoided, post FRS10, in favour of capitalisation but that strategy still does not remove the “inherent contradiction” referred to previously in conclusion two.

The recursive cycle presented by Figure 7.2, whilst positively reinforcing in respect of asset measurement, may be regarded as negatively reinforcing in respect of asset recognition because it is axiomatic that asset recognition is logically prior to asset measurement and, yet, this inescapable logic is deliberately reversed within the existing signification structure. Thus, in addition to the inherent contradiction raised by conclusion two within the signification structure there is also the contradiction raised by those non-transactions-based, internally generated intangible assets falling outside the signification structure – the tension raised in Boxes F and H in Figure 7.3 and their related omission from the balance sheet.

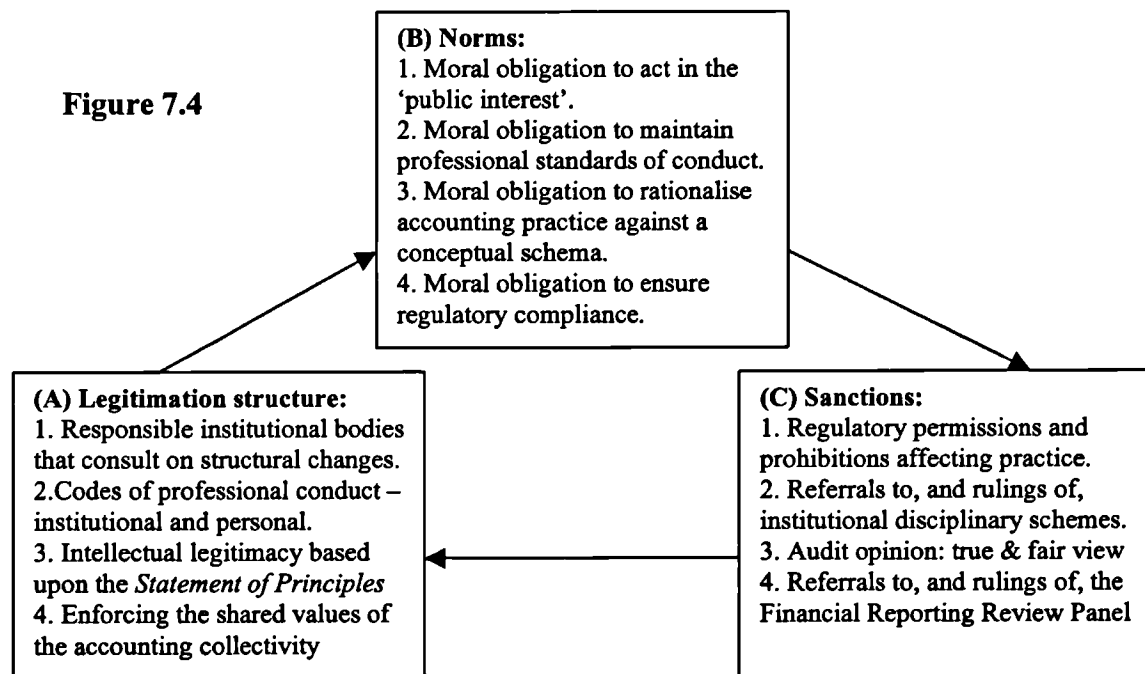
## **7.2. Legitimation**

The contradiction and omissions from the balance sheet raised in section 7.1 speak of a selective portrayal of financial reality, yet, in the knowledge of its shortcomings as a financial statement (ASB, 1999 supplement, p22), the Board is still able to legitimate their incomplete picture of financial reality as an apparently acceptable one in the eyes of

society. In this regard, the summary at the end of section 7.2 will attempt to answer the first part of the central research question: “How is the Accounting Standards Board able to legitimately construct and perpetuate a portrayal of financial reality...”, that is, despite this portrayal of reality being one “...that currently includes ‘purchased’ goodwill and, at the same time, excludes many intangible assets...” as explored previously in section 7.1.

The recursive elements of legitimation are repeated in Figure 7.4 (same as Figure 5.2).

Figure 7.4 links to the second column of boxes in Figure 7.1.



First, let us address the legitimation structure (Box A, Figure 7.4).

### 7.2.1. Legitimation structure

The legitimacy afforded by national, legal and quasi-legal social structures, as addressed in section 5.1.1, is developed and underpinned by a process of consultation that is undertaken

prior to their final construction. Consultation is a way for the profession to be *seen* to act in the public interest, but, as was shown in section 5.1.2, the claim of acting in the public interest does necessarily flow from a majority consensus viewpoint of those who were consulted. Where a consensus is obtained, the resultant dominant coalition simultaneously legitimates the institutional structures as responsible entities. Where this is not the case, then power has been exercised to create what is illegitimate. Such illegitimacy may be passively accepted, as with the tying of impairment reviews (illegitimate) to systematic amortisation (legitimate) in FRS10, or, it may even be overturned, as with SSAP16 on Current Cost Accounting.

The legitimacy of the profession to construct financial reality through accounting standards is enhanced not only by compliance with the rules of accounting but where those same rules are grounded on a rational conceptual framework (section 5.3). Underpinning any claim to legitimacy by reference to a conceptual framework are two notable features: the role of definitions in the construction of accounting reality and the paradoxical inclusion of subjective policy decisions in a supposedly objective framework, particularly in respect of mixed measurement bases in accounting. Thus, the two principal features of the signification structure, raised in section 7.1, are legitimated by reference to the conceptual framework presented in the *Statement of Principles* (ASB, 1995b,1999).

However, the efficacy of a ‘principles guiding accounting practice’ approach is undermined by divergent practice and where practices occasionally conflict with principle. A repeated theme of this thesis has been the efficacy of the definition of an asset in that regard. Since the tension posed by a ‘principles guiding accounting practice’ approach is inherent to the legitimational structure, then it may be argued that there needs to be other

social structures that can improve the objectivity of financial statements, notably through consistency in practice. In other words, since accounting rules and related accounting practices cannot be consistently judged against a supposedly objective conceptual framework then, perhaps, it is better to be consistently right or consistently wrong in practice for the sake of comparability between accounts. Two legitimation structures were pertinent in this regard. First, the consistency of accounting practice according to the rules of accounting should be policed through the existence of an audit function (section 5.4.1) and regulations (section 5.4.2) that legitimate the independence of that function as well as in the manner that that function is fulfilled. As sections 5.1.1 and 5.4.2 showed there are also institutional changes being developed jointly by the profession and the State in order to enhance the independence of this policing role. Second (and this is also applicable to the auditor), that the scope for variation in the professional conduct of accountants should be minimised through a process of moral inculcation, structured by education and a professional training over many years and reinforced by codes of professional conduct (section 5.2.). That said, there will always be an element of challenge and negotiation between the accountant and the auditor on what constitutes moral behaviour in a given situation, particularly where that situation is not covered by an accounting rule. Where audit negotiation fails, the main enforcement structure is the FRRP – addressed in section 5.4.2.

### **7.2.2. Norms**

Let us address next the norms of behaviour related to the legitimation structure (Box B, Figure 7.4). Four normative rules were explicated in chapter five.

The first normative rule is that the profession has a moral obligation to act in the public interest by fulfilling its socially supported role to regulate the practice of accounting. The key word in this sentence is 'support'. Section 5.1.1 showed that the structural changes that are currently taking place in accounting are extensive and are intended to legitimate the profession as a trustworthy institution that responds to the concerns raised by Enron and WorldCom before they could possibly happen in the UK. Yet, despite the proposed structural changes to the institutions of accounting, and their pronouncements, the social action of accountants can sometimes fail to inspire confidence where corporate failures continue to occur. And, they still occur despite these institutions now being more closely aligned to the organs of the State. The root problem is that the professional institutes and the State seek to effect change to social structures as means of affecting social action (compliance with accounting rules) but these structures can do little to address the real issue: the ingenuity of those parties intent on fraud and the personal drive associated with human greed. Yet, at the same time, the support of society for the profession is conditional upon the continual search to minimise financial malpractice – a societally imposed norm to which there is attached the moral obligation on the profession to achieve it.

The second normative rule is that the professional institutes should regulate accountants through professional norms of behaviour. It is incumbent upon the accounting profession (of which the ASB is a part) to ensure that, as far as possible, those who practice accounting are professionally and morally responsible, as already outlined previously. Of course, in common with the concluding comment in respect the first norm, the imprimatur of professionalism is not a protection against accounting manipulation, malpractice and fraud.

The third normative rule is that there is a moral obligation to regulate the practice of accounting through a rational conceptual schema. The purpose of a conceptual framework is to show that where social action is different from the behavioural norms established by such a conceptual framework, that the relevant action may be subject to 'objective' moral judgement, as already outlined previously. As with the previous norms, the existence of a conceptual framework is no protection from those whose approach is based upon self-interest and commercial pragmatism rather than any conceptual stance.

The fourth normative rule is that accounting regulations should affect accounting practice and that controls should be in place to ensure compliance. Compliant action will be judged according to the rules and principles promulgated by revised bodies such as the APB, as enforced by the FRRP (see Figure 5.5). This is where the efficacy of 'structural change preventing accounting malpractice' will actually be tested.

### **7.2.3. Sanctions**

There does need to be some form of control over compliance with the rules of accounting if only to maintain what is or is not legitimate for accounting purposes. Let us summarise that point next when we look at the issue of sanctions– Box C, Figure 7.4.

Without the possibility of sanction, such as disciplinary action, the profession could easily be seen as being ineffectual in protecting the public interest in the provision of reliable and relevant financial information. However, this view of sanctions is unnecessarily restrictive because sanctioning may also be regarded as a means of permitting 'right' behaviour, typically in compliance with the rules of accounting as well as prohibiting 'wrong' behaviour. In both cases, the intention is to positively reinforce the legitimation structure.

For example, it is axiomatic that the vast majority of audit opinions are supportive of the accounting practices and of the financial statements presented for public consideration. This is an effective sanction insofar as a qualified audit opinion can sometimes have a seriously detrimental effect on a company in that it may precipitate a loss of confidence and therefore a collapse in orders, withdrawal of liquid funds etc. which could have, otherwise, been avoided.

Another effective sanction has been the threat of referral by the FRRP to the Courts for rectification of a set of accounts, a social action. Let us summarise by comparison to the structural changes taking place in the enforcement mechanisms of accounting (see section 5.4.1 and 5.4.2).

The key feature of FRRP sanctions is the switch from corporate censure to the private censure of the directors should an FRRP ruling ever be challenged in court – and no challenge has ever been forthcoming (see again the press notices in Table 6.8). In contrast, as we saw in sections 5.1.1 and 5.4.2., following publication of the CGAA (2003) report, a substantial amount of institutional structural change is underway (Audit Committees, a proactive FRRP, the creation of the IDB etc). However, such change is structurally focused (Box A, Figure 7.4) and not necessarily focused on social action (Box C, Figure 7.4) as is the case, comparatively, with the above switch from corporate censure to private censure. The unspoken assumption accompanying the above institutional structural change is that structural change will lead to behavioural change that positively reinforces those revised/new social structures, such that the scope for future corporate collapses are minimised. But, of course, it is only an assumption. In contrast, the threat of private censure is a very effective sanction that is in the first instance focused on human action



personally, not structurally, and, thereby, also enhances the legitimacy of the FRRP as an institution that pursues the individual person as well as the corporate person – a very effective use of power, addressed in section 6.3.

#### *7.2.4. Summarising in relation to the central research question*

Let us return to the first part of research question: “How did the Accounting Standards Board construct and perpetuate a portrayal of financial reality...”. The signification structure (section 7.1) is central to the accounting construction of financial reality. Since it presents a selective version of financial reality (excludes internally generated intangibles) it should, nevertheless, be legitimised as an acceptable social construction in the ‘eyes of society’ otherwise the pre-eminent role of accountants in the financial reporting domain might be revised or removed in favour of parties who can serve society more effectively (those who might, for example, include internally generated intangibles in their social construction?). In order to perpetuate the accounting version of financial reality the signification structure should therefore be seen as an objective construction, vis-à-vis a conceptual schema and supporting rules, produced by persons who maintain professional standards of integrity and independence. However, as was shown in this section, objectivity, whether rules and/or principles based, is illusory. The profession seeks to perpetuate a portrayal of financial reality that is inherently subjective in the manner of its construction and, therefore, legitimacy is really about constructing rules and policing the application of them with a view to achieving consistency and comparability between accounts. Being seen to be consultative, being seen to be responding to corporate collapses through structural changes, being seen to act professionally are all ways of legitimating the financial reporting role of the profession in society but it is ‘rule creation and rule enforcement’ that is the vital feature in the process of the legitimately constructing and

perpetuating a portrayal of financial reality. The domination of this ‘vital feature’ is summarised next.

### **7.3. Domination**

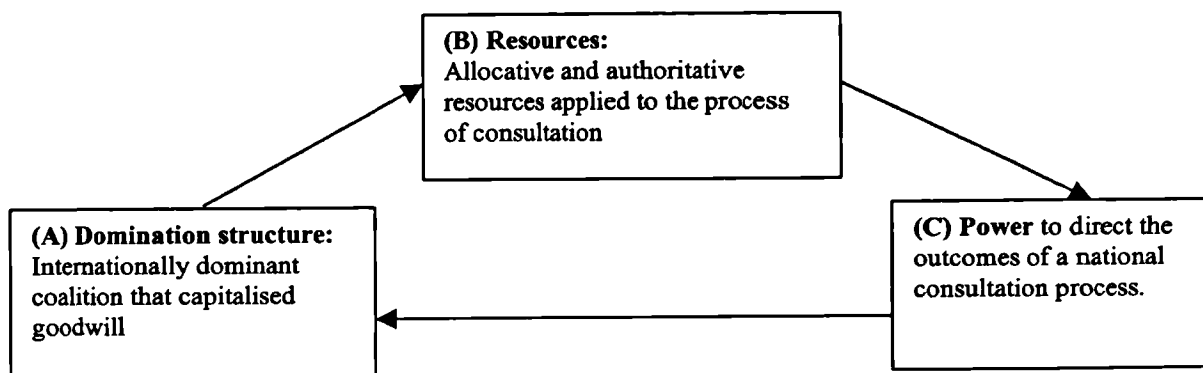
Having addressed the first part of the central research question in section 7.2 and the middle part of it in section 7.1, we return to the final part of the central research question presented at the beginning of this chapter. Specifically, that the Board’s selective portrayal of financial reality, one that currently excludes many intangible assets, is a social construction that is “...in opposition to those parties, inside and outside the accounting domain, who argue the case for their inclusion on the balance sheet? How, despite such opposition, the Board’s stance on this matter is able to dominate in practice will be the subject of the summary presented in this section.

The recursive elements of domination are repeated in Figure 7.5 in respect of the rule creation cycle (same as Figure 6.3) and in Figure 7.6 in respect of the rule enforcement cycle (same as Figure 6.5). Figures 7.5 and 7.6 link to the third column of boxes in Figure 7.1.

#### **7.3.1. Rule creation**

Let us summarise cycle one commencing with the domination structure (Box A, Figure 7.5).

**Figure 7.5: Rule creation cycle one**



At first glance, there appears to be a contradiction between social action (Box C) occurring at the national level and a domination structure (Box A) that presents an internationally dominant coalition built around the capitalisation of goodwill, including impairment reviews. The clear implication is that the process of national consultation will be directed towards the above internationally dominant structure regardless of the outcome nationally. Where they are complementary then convergence is obtained; where they are not, then the international structure simply dominates. As was shown in section 6.1.1, the domination structure was also indirectly supported by a national stance that was unsustainable in terms of reserve depletion and the mitigating effects of accounting arbitrage.

**Conclusion five:**

Power was exercised by the Board to steer the process of consultation from its outset towards their predisposition for asset-based approaches to goodwill and intangible assets with indications that this pre-disposition was being driven by a desire to comply with international regulatory structures.

Let us turn to the resource utilisation issue in respect of cycle one (Box B, Figure 7.5). The analysis presented throughout section 6.1.3 does not present power as something lying only in concrete allocative resources, rather in the process of interaction and in the capacity of the Board to organise and coordinate the actions of social actors. The ability to organise and coordinate social actors constitutes the authoritative resource at the Board's disposal, in this case, the manner in which the process of consultation would take place.

Let us now summarise the consequences of the exercise of power in that regard (Box C, Figure 7.5).

The analysis presented in section 6.1.2 showed that when one aggregated the respondents' preference for asset-based accounting methods A, B, C, there was a majority (59%) in favour of capitalisation from the outset of the consultation process. It was an advantage that the Board failed to communicate in its own analysis. That analysis referred to 50% preference for capitalisation with an attendant 50/50 split between amortisation and impairment reviews (ASB, 1995a, p5). As was shown in section 6.1.2, this was not the case. For example, Table 6.2 showed that support for impairment was only 17% of the respondents, not 25%, unless one also adds those parties who opted for the dual-track amortise/impair approach (9%).

What appears to have happened is that the Board could see from the responses to the discussion paper the emphatic rejection of impairment reviews (or ceiling tests as it was then known) but rather than report that rejection it was, instead, reported as no 'clear-cut' response towards asset-based methods (which was incorrect - see above). That rejection was emphasised and enhanced in the responses to the working paper and, again, the adverse comments concerning impairment were ignored in the subsequent analysis. Yet, at the same time, there was a growing consensus for asset-based approaches towards purchased goodwill. Though speculative, this indicates early on in the process a fixed attachment of impairment reviews to any asset-based approach to purchased goodwill regardless of the outcome of the consultation process.

There were instances where the Board did take ‘on-board’ the views of the respondents in the determination of its rules. The most notable adoption in this regard was the separable disclosure of intangible assets extracted from purchased goodwill and the separable disclosure of intangible assets on the basis of a readily ascertainable market value or RAMV. In both cases, though, the reliability of transactions-based measurement was paramount in the recognition process (per the signification structure), as opposed to valuations constructed independently of a transactions basis. Equally, there were instances where the Board did not take ‘on-board’ the views of the respondents, as with the adoption of impairment against the wishes of the collectivity. In the first case it may be argued that the Board was able to accommodate the collectivity without undermining the signification structure through a widespread use of valuations. In the second case, power of the Board was mobilised to override the wishes of the majority of respondents.

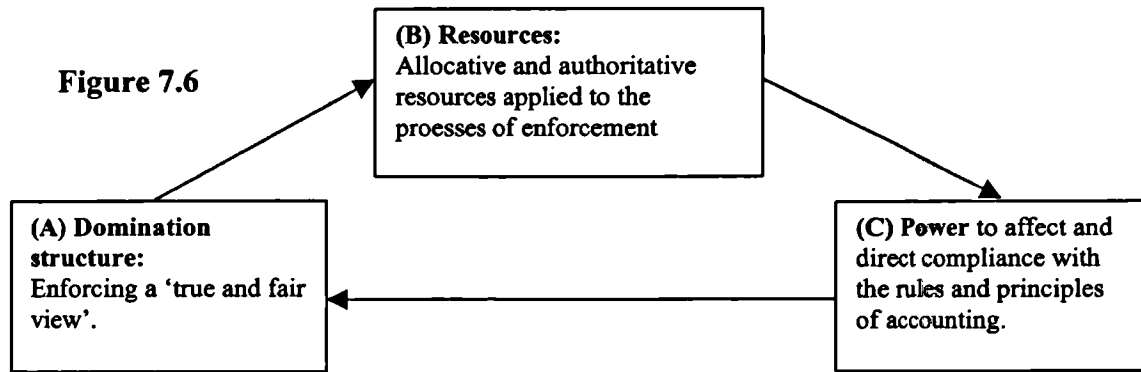
**Conclusion six:**

Attempts at building a dominant coalition through consultation does not necessarily result in a consensus. The dialectic of control operates between the Board and the respondents to its consultation process but a majority opinion on an issue does not necessarily apply to the subsequent rule construction where power is exercised to do otherwise. This also has implications for the legitimisation structure because the legitimacy of the Board as a socially responsible entity is weakened (the SSAP16 debacle being a case in point) where, following consultation, the consensus position on an accounting policy is deliberately ignored or overridden by the Board in the subsequent construction of an accounting standard.

It remains to be seen whether the Board’s decision to override the consensus against impairment reviews will be reinforced in practice – a positively reinforcing recursive cycle. At present, the issue does not arise in practice to any great extent because of the use of the preferred alternative option in FRS10 to amortise goodwill, instead.

### **7.3.2 Rule Enforcement**

Let us now summarise cycle two as presented in Figure 7.6 (restated from Figure 6.5).



First, let us address the domination structure of cycle two (Box A, Figure 7.6). The dominant rationale that guides enforcement is the pursuit of a true and fair view. As with the 'principles versus rules' based tension raised in respect of the legitimisation structure (section 5.3), the same tension was raised in respect of the domination structure. In general, enforcing a rules-based approach is what dominates in practice though this may occasionally be tempered by the application of principle as we saw in respect of PN73, in section 6.2.2. Applying a rules-based approach to enforcement can lead to anomalies arising within that social structure. An example was presented to that effect in section 6.2.1. The purpose was to show that the true and fair view of financial reality that accountants seek to show is always a problematic one to interpret within the existing rules of accounting but, also, outside those rules, as with internally generated intangible assets. Thus, domination occurs but this is always on the subjective basis of an opinion (audit opinion) and, if necessary, a second opinion (the FRRP) of what 'correctly' constitutes a true and fair view of financial reality.

Let us turn to the resource utilisation issue in respect of cycle two (Box B, Figure 7.6). Allocative and authoritative resources were applied to the process of enforcement which, by the nature of cycle two, must possess the element of force about them, threatened

and/or applied, otherwise these resources would be seen to be ineffectual. However, all the profession or the State can realistically do in respect of enforcement is apply more allocative and authoritative resources to make it harder to 'cheat the system' by institutional change and by attempts at what is deemed to be 'more effective' regulation or laws. The single most effective resource in that regard was the possibility of referral by the FRRP to the Courts under s245b CA85. By switching the liability for such legal actions from a corporate one to a personal one, the authority of the FRRP was enhanced immeasurably.

Finally, let us turn to the exercise of power in respect of cycle two (Box C, Figure 7.6).

A dominant coalition is also built around wholesale compliance with the accounting rules, where necessary, enforced by institutional structures such as the FRRP. It follows that a rule change should lead to a change in behaviour in full compliance of the new rule. As we saw when we looked at the FRRP press notices this can sometimes lead to diametrically opposed, yet legitimate, rulings as the accounting rules change over time - see PN64.

Overall, despite such anomalies, failure to comply with accounting rules risks undermining the social structure posed by accounting standards and auditing standards and, by extension, the institutional structures that promulgate and enforce them.

**Conclusion seven:**

Enforcement may be directed towards the institutional social structure, as with an adverse audit opinion and the related adverse publicity. Enforcement, thereafter, may be directed towards the social action of the directors personally under s245b CA85. The respective switch in focus from the 'corporate' to the 'personal' constitutes a very effective means of enforcing the auditor's version of truth and fairness and with it the norms of the accounting collectivity.

In contrast, revising social structures (institutional, regulatory and conceptually-based ones) as a remedy for malpractice and fraud simply provides new opportunities for those parties intent on manipulation to circumvent them. Thus, normative rules on what *should*

*be* moral behaviour are undermined by the power of individuals to do otherwise and no amount of structural revision, particularly at the institutional level, is going to completely eradicate the opportunity and consequences of immoral behaviour in that regard.

A serious challenge to the power of the Board to construct its own version of financial reality is raised by attempts at accounting arbitrage between nation states or between companies nationally. Streamlining the national and international rules of accounting for goodwill toward its capitalisation only, reduced the scope for arbitrage but the exercise of power in this regard was not unidirectional for three reasons. First, it was possible to circumvent the spirit of the rules and still remain within them, as with brand assets extracted from purchased goodwill. Second, whilst the post-FRS10 capitalisation of both goodwill and other intangible assets considerably reduced the scope for arbitrage between them, nevertheless, some arbitrage could still occur through differential amortisation rates. Third, whilst compliant with the rules operationally there may, nevertheless, be anomalies that raise doubts about the accounting principles themselves, that is, conceptually. In this latter regard, the example presented section 6.2.1 highlights the weakness of the boundary between an asset and an expense and the related discretion allowed to accounting actors in the determination of an element for accounting purposes. And it is at this boundary that intangible assets are located.

### *7.3.3. Summarising in relation to the central research question*

Let us return to the last part of the research question, that is, how the Board's version of financial reality can dominate despite the "...opposition [of] those parties who argued the case for their inclusion [notably, internally generated intangible assets] on the balance sheet? In the case of the rule creation cycle the process of consultation was deliberately



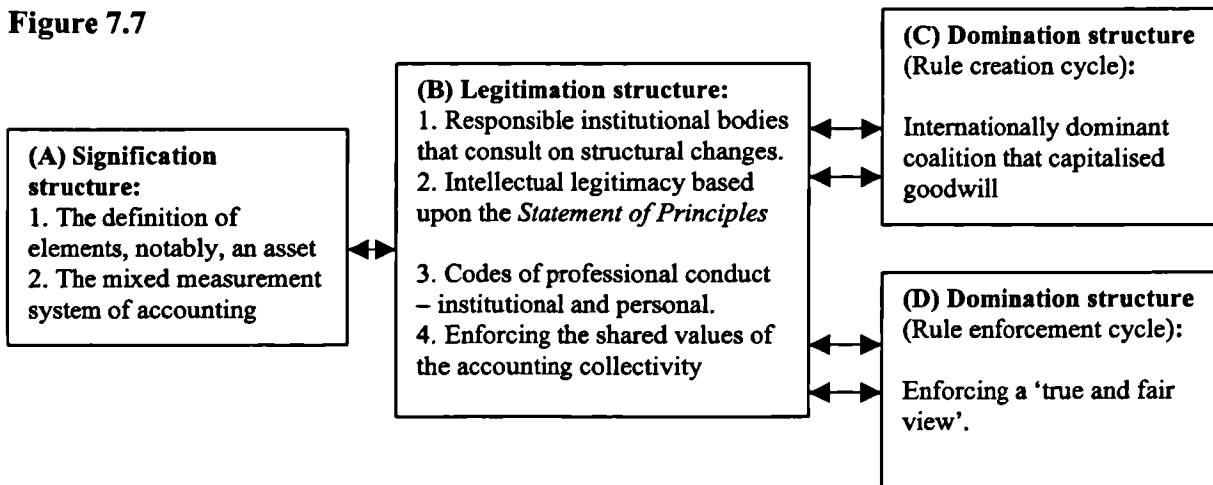
steered towards an asset-based solution that protected the existing transactions-based signification structure, one that excludes non-transactions-based internally generated intangible assets. In other words, the case for the inclusion of non-transactions-based internally generated intangible assets was simply overridden.

The FRS10 solution amounted to a compromise in that it allowed two accounting methods to be used: amortisation and/or impairment subject to the capitalisation of goodwill and intangible assets. However, it was also a solution that remained firmly within the signification structure and, in respect of RAMV's, could be said to have strengthened by emphasising their transactions basis. In respect of the rule enforcement cycle, whilst the longitudinal survey, unsurprisingly, showed a high degree of compliance with FRS10, there were also examples from the survey, such as the earlier Mirror Group Plc example, which showed that such compliance also produced conceptually based anomalies. Such anomalies lead one to question the validity of the signification structure, in particular, the definition of an asset. However, this was ignored through an exercise of the Board's power to ensure that such thinking was excluded.

#### **7.4. Explicating the cross structural and cross agency links.**

Let us first look at the cross-structural links in Figure 7.1 (the double headed arrows) as presented in detail in Figure 7.7.

**Figure 7.7**



The explication of Figure 7.7 will flow from left to right tracking, first, boxes A,B and C, then, A, B and D. The split in the legitimation structure (items 1,2 and items 3,4) shows the main linkages to the subsequent domination structures: rule creation and rule enforcement respectively, but the linkages are not exclusive. For example, the *Statement of Principles* (item 2) could be said to be relevant to the issue of establishing a 'true and fair view' (Box D, Figure 7.7) since that 'view' should be informed by such principles even if they are silent on the issue of enforcement.

#### *Tracking Boxes A, B, C in Figure 7.7.*

There are two key points to make about the signification structure in Box A, Figure 7.7. First, the two main structural characteristics summarised in section 7.1.1 and presented in Box A have more to do with the *Statement of Principles* (ASB, 1995b, 1999) rather than *FRS10* (ASB, 1997) and, second, those characteristics **were not going to change**. Thus, the structural foundations of accounting itself remained intact during a period of specific regulatory change. This, perhaps, is as it should be for all standards-setting except that in respect of the period of regulatory change concerning FRS10 it was not a question of the 'Statement of Principles generally informing FRS constructions', rather, the construction

of purchased goodwill in FRS10 being a direct consequence of applying those Principles (see conclusion two, again). Specifically, the goodwill measurement “difference” (the purchase cost of a business and the fair values of the separable assets, per *FRS10*) arose from mixed measurement system that was bound, inherently so, to create differences of measurement per the *Statement of Principles* (Box A, item 2, Figure 7.7), and the variability of those principles (specifically, the definition of an asset) in terms of the subsequent categorisation of that goodwill measurement “difference” as an asset or an expense (Box A, item 1, Figure 7.7). The linkage of FRS10 to the Statement of Principles on this mixed measurement issue is a specific one, not a general one, as would be the case for most other FRS constructions. In other words, the nature of the purchased goodwill “difference” at the micro level (in FRS10) simply reflected what was being constructed by the Board at the macro level (in the Statement of Principles).

The legitimacy of the profession to construct financial reality is, in part, grounded on a rational conceptual framework: the *Statement of Principles* and, by extension, the intellectual legitimacy derived from the concept of ‘principles guiding accounting practice’ (Box B, item 2, Figure 7.7). That is the de jure position of the profession. The de facto position was somewhat different because the Statement of Principles did nothing to inform at the conceptual level of enquiry as to whether, in principle, purchased goodwill was an asset or not. In other words, whatever was the dominant influence (Box C, Figure 7.7) guiding the change from goodwill non-asset, pre-FRS10, to goodwill asset, post FRS10, it had little to do with the legitimacy afforded by the Statement of Principles. Had it done so and concluded that, say, goodwill was not an asset then the asset-based approach of FRS10 would have been made redundant. In contrast, as has already been pointed out under the ‘signification’ heading, above, the specific construction of purchased goodwill in FRS10

was actually a residue from that mixed measurement-based conceptual framework, a framework that allowed a wide discretion as to what would count as an asset or not for accounting purposes. And, to repeat, those principles were not going to change because broadening the goodwill debate to include such matters would have inevitably led to a never-ending process of consultation. As a result, of the two items (items 1 and 2, Box B in Figure 7.7) the process of consultation (Box B, item 1, Figure 7.7) was, perhaps, the more active ‘ingredient’ in legitimating the above structural change from ‘non-asset’ to ‘asset’ status. This is because the consultation process took place at the technical level of enquiry (the offering of six accounting methods in the discussion paper (ASB, 1993)) and thus, largely avoided the above conceptually based concerns. Legitimacy was therefore advanced on the basis of preferences for certain accounting practices, those preferences being dominated (Box C, Figure 7.7) by international preferences from the Board’s viewpoint.

In considering, next, the linkage of signification and legitimation to the domination structure (Box C, Figure 7.7) one cannot completely ignore the impact of the *Statement of Principles* insofar as there is a high degree of commonality between the conceptual frameworks produced by the ASB, FASB and the IASB. For example, the definitions of an asset share the same characteristics of future economic benefits being triggered by past transactions or events. The same argument is also applicable in respect of purchased goodwill. However, it was not the dominant influence affecting the decision to capitalise purchased goodwill for the reasons given previously, notably, in terms of the broad discretion the definition of an asset gave to accounting actors in their determination of the element that should be capitalised, or not. The stronger influence affecting the domination structure was its mimetic isomorphic nature directed towards compliance with the

internationally dominant stance of capitalisation and, subsequently, in respect of impairment reviews. As we saw, this raised problems where the consulted views of the respondents at the national level were in conflict with international norms and the Board selectively overrode them in favour of those international norms of conduct.

*Tracking Boxes A, B, D in Figure 7.7.*

The above comments in respect of the signification structure (Box A, Figure 7.7) are still applicable here.

The problem with discretionary accounting choices in practice or switches in accounting policy choices (as with goodwill) is that they undermine comparability between accounts and potentially, the profession's status as society's main financial information provider. It, therefore, becomes important to ensure that whatever construction of financial reality is offered it is, nevertheless, shared by the accounting collectivity (Box B, item 4, Figure 7.7), applied consistently in practice and accepted by society as a reliable version of it. This is because legitimacy in accounting has more to do with social acceptance rather than scientific proof against some objective framework. As we saw, such 'objectivity' is paradoxically grounded on 'subjective' policy choices anyway. The means of deriving social acceptance is by being seen to be consultative with a view to establishing a consensus on an issue, also, by attempts at harmonising standards internationally, as summarised above. However, the means of maintaining that social acceptance is by claims to professionalism (Box B, item 3, Figure 7.7): highly educated and trained individuals who can be trusted with the societally important task of producing reliable and relevant financial information.

A cornerstone to accounting claims of professionalism is their transactions-based system of recording of financial reality, a cornerstone that is eroded by valuations constructed independently from it. This shared value system is so firmly entrenched that where it comes to a choice between the recording of transactions-based cost or a valuation, where this is allowed, the former dominates. As Egginton (1990, p195, brackets added) comments:

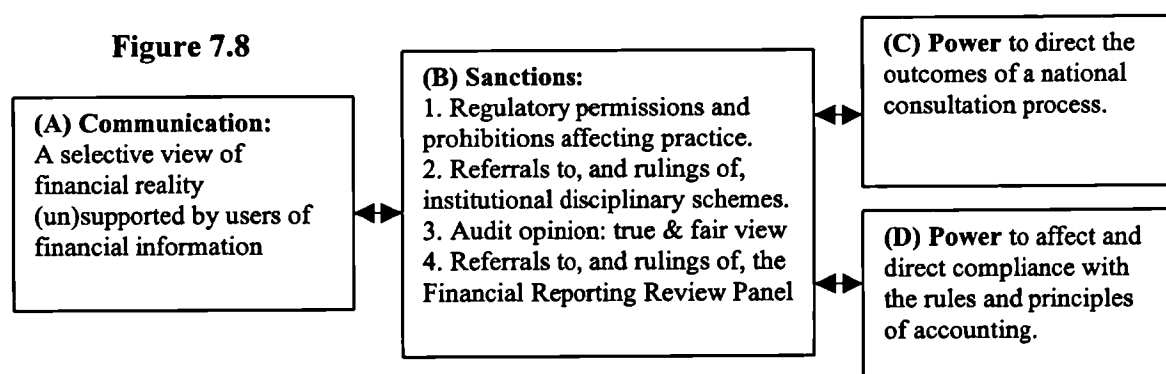
“The biggest hurdle for recognition of intangibles may be an innate preference for tangible assets in accounting conventions, rather than questions of expected future benefits [per conclusion one, previously] or whether magnitudes are sufficiently reliable for recognition [per conclusion three, previously].”

Thus, the true and fair view of financial reality (Box D, Figure 7.7) is always an incomplete one, the “innate preference” being for transactions-based records of account even though there has clearly been a shift towards a more economically orientated view of accounting that would naturally favour the greater use of valuations, as with RAMVs (readily ascertainable market values).

At this juncture it is worth comparing the domination structures in Box C and Box D, Figure 7.7. The enforcement of accounting truth and fairness (Box D) is usually according to the accounting rules. The FRRP, in most cases, will seek to enforce against those rules except where the true and fair view override is appropriate or the matter in hand is not covered by a rule. It follows that a rule change can lead to a change in the accounting portrayal of ‘truth’ sometimes diametrically so, as was the case with purchased goodwill. It also follows that the pursuit of truth and fairness is illusory because it is matters ‘who’ is promulgating the current view of it, which is why the imprimatur of professionalism (Box B, item 3, Figure 7.7) is so important to the accountant. It legitimates him/her as someone who can be trusted to give a formal opinion on truth and fairness. Yet, because this portrayal of ‘truth’ is so contestable, the profession also seeks to to replicate the manner of

its construction internationally as well as nationally so that at least the financial representation is a widely shared or dominant one even if it is not necessarily a 'fair' one, depending on one's viewpoint (Box C, Figure 7.7).

Let us now look at the cross-agency links in Figure 7.1 (the double headed arrows) as presented in detail in Figure 7.8.



The communication of meaning (Box A, Figure 7.8) draws heavily upon the rules of accounting. Whatever meaning is communicated to users of accounts it is a selective one depending on what is permitted or prohibited according to those rules (Box B, item 1, Figure 7.8). Ideally, those rules should be legitimised by their widest possible acceptance by society. However, as we saw in respect of impairment reviews, power may be exercised to effectively compel acceptance, instead (Box C, Figure 7.8). An example of the resultant selectivity in the construction of financial reality was Mirror Group Plc, which showed that there may be full compliance with a goodwill accounting rule-change but, at the same time, there may still be underlying problems with the principles on which the practice is supposedly based. In this example, the same intangible asset over three consecutive years was included, then excluded, then included again on the balance sheet as an asset according to a rule change and the requirement for transactions-based asset recognition.

Thus, with each change in asset status to non-asset status to asset status, respectively, one is legitimately entitled to ask whether the resultant construction of financial reality is supported or not by those who rely on the meaning conveyed by such variability in practice. Notable in this regard was the inability of the definition of an asset to differentiate an asset and an expense and, at the boundary between them, intangible assets such as goodwill. All that mattered was compliance with the rules, not the principle of whether the expenditure was an asset or not. The fact that goodwill, unlike any other asset, had changed its disclosed 'asset' status irrespective of any guidance from the definition of an asset, supports this assertion. Nevertheless, that annual construction of financial reality would have been sanctioned by the profession on the basis of an audit opinion (Box B, item 3, Figure 7.8) as being compliant with the accounting rules and, therefore, the correct one to place in the public domain.

An overarching policy that guides social action is that the profession should be seen to be acting in the public interest in the provision of financial information. It therefore matters 'who' is acting in that regard, specifically, that they should conduct themselves professionally and that, if not, that they should be sanctioned accordingly (Box B, item 2, Figure 7.8). Typically, professionalism is interpreted as being in compliance with the rules of accounting but with rule changes, such as those outlined in respect of Mirror Group Plc, that professionalism may be subject to sanction outside as well as inside the profession, specifically, those who would challenge the inconsistency of such practices. Thus, the notion of acting in the public interest is broadly based and will include those parties who believe that on certain issues they can offer a 'better' version of financial reality, as with some brand valuation companies. For accountants though, compliance with the rules is what matters. Where there is dispute about the resultant construction of financial reality



that construction is subject to further sanctioning: a second opinion (in addition to the audit opinion) through the rulings of the FRRP (Box B, item 4, Figure 7.8). And, such sanctioning seldom needs to be enforced (Box D, Figure 7.8) through the exercise of power because of the effects of s245b of the Companies Act on the directors personally.

One may surmise from the above assessment that the moral authority of the profession to construct and enforce financial reality on behalf of society is weakened in two respects. First, it is weakened by a conceptually eclectic foundation (law, economics and political policy choices) to the principles underpinning accounting practice, particularly where conflicts arise between them (see FRRP Press Notice No. 73 for an example concerning goodwill and the use of the true and fair view override). Second, it is weakened where, following consultation, the consensus position on an accounting policy is deliberately ignored or overridden by the Board in the subsequent construction of an accounting standard.

### **7.5. The limitations of this research**

1. The choice of structuration theory was conditioned by the use of Laughlin's (1995) theory, method and change matrix. In respectively selecting a Medium/Low/Low positioning within a Kantian/Fichtean philosophical perspective, there was only one method to choose according to the content of Figure 3.2. In this regard, the feature of structuration theory that distinguishes it from the other research approaches within a Kantian/Fichtean philosophical perspective, are its 'skeletal' structural characteristics, as summarised in this chapter. Of course, this is not to say that Figure 3.2 is comprehensive with regard to the range of research methods that could be fixed within this structure.

2. Whittington (1992, p697) argues that although Giddens himself is satisfied with the robustness of his concept of structure, it "...nevertheless continues to be accused of excessive subjectivism." So, for example, the legitimisation structure includes the issue of professional conduct, which applies to accounting as a whole and not just in respect of goodwill and intangible assets. This aspect of legitimisation is not necessarily located in any particular time and space, that is, the consultation period 1993-1997 and the data sets presented in this thesis. Whether this, or any other means of legitimisation, is included or not in the analysis presented here is, to some extent, a subjective decision on the part of the researcher. And, what may be included can also be excluded according to that direction – hence the engagement with the research site is complete, per chapter three. Other criticisms of Giddens include the risk of conflating social action with social structure (see Archer, 1989). Much of the criticism relating to structuration theory is therefore grounded on this central notion of the duality of structure – the interaction of social action and social structure. So, for example, the recursive cycles presented at the beginning of chapter four, five and six emphasise the duality of structure for each of the three levels of structuration. What is not indicated is the *extent* and *strength* of that recursiveness. Let us consider that point further.

With regard to the *extent* of the recursive cycles, consider the following two examples. In respect of rule creation, once the recursive consultation process culminates in an accounting standard then, it could be argued, that the cycle stops until such time as the rules are revised or withdrawn. On the other hand, a recursive cycle that communicates financial information on the basis of a mixed measurement basis is one that can run perpetually with every reporting cycle. With regard to the *strength* of the recursive link between social structure and social action, consider the following example. An

enforcement cycle that is passive most of time (not requiring the intervention of the FRRP) could be viewed as a contradiction in terms. The implication is that with each repeating reporting cycle the social actions of management and their auditors are permanently conditioned by the possibility of FRRP sanctions should they not agree upon the final form of the annual financial statements. This conditioning, though, is assumed, not proven. As such, it calls into question the strength of the linkage of social structure and social action where that strength has not/cannot be empirically tested.

The critical picture painted so far does not negate the research method which, to repeat a point made in chapter three, is more in the nature of a sensitising device on the issue of goodwill and intangible assets. And, it is a particularly useful one to adopt. For example, whilst it was important to highlight the two central features of the signification structure and their impact on the disclosure, or not, of purchased goodwill and internally generated intangibles, the key issue wasn't so much the weaknesses of these two features but the fact that a 'transactions basis' and a 'mixed measurement basis' to accounting wasn't going to change. It follows that any standard setting consultation process was automatically preconditioned by this structure and that there would be a strong likelihood of power being exercised to protect it despite the comments of the respondents as to the practical difficulties with this social structure. It is this sort of dynamic, with its interaction of social action and social structure, which structuration theory highlights effectively.

3. Turning now to the respondent data sets. There was no problem in terms of their collection from the ASB, however, there was a problem in terms of their analysis, notably in respect of FRED12. The views of the respondents were examined first, insofar as they related only to the existing social structures of accounting (this links to point 2,

immediately above), second, insofar as they were capable of being reduced to a tabular Yes or No response given the ambiguities of language (for example Table 6.3).

With regard to the first comment, the use of structuration theory was focused towards *what is* rather than what *should be* an appropriate social structure in accounting for purchased goodwill and intangible assets. Thus, for example, whilst the conceptual issue of separability was addressed in chapter two, it did not form a large part of the analysis of the largely technical debate surrounding the choice of accounting methods presented in chapters four, five and six. As such, there were many normative, conceptually based comments by the respondents concerning separability that have fallen outside the scope of this thesis.

With regard to the second comment, above, it was fairly 'straight forward' to analyse the respondents comments to the discussion paper and the working paper into a tabular form. One can strip away all the conceptual and practical qualifications to a decision to choose a particular accounting method. However, with FRED12, the mixture of lingering support for accounting methods now removed by the Board, notably in respect of elimination-based methods, together with an apparent desire not to be seen to standing in the way of progress, made the tabular analysis presented in Table 6.6 a somewhat subjective one to perform because the many contradictory statements made by the respondents.

4. The second data set, the longitudinal survey (appendix A), was presented in order to confirm practical compliance with accounting rule changes, pre and post FRS10. However, much more could have been done with it other than in respect of domination alone. For example, there have been comments on the impact that SSAP22 had in terms of reserve

depletion (see also Tollington, 1994) but the opportunity to analyse that impact using regressions was omitted. Part of the reason relates to a word count limit but one may also argue that an extensive quantitative analysis would have been largely incidental to the predominantly qualitative analysis of the comments of the respondents to the consultation process leading up to the implementation of FRS10.

5. The focus of this thesis has remained largely within the national consultation process covering the period 1993-1997. Any assessment, for example, of the impact of international developments has tended to remain mostly within that context. Yet, since 1997, the pace of international change in respect of goodwill and intangible assets has continued at a pace culminating perhaps in IFRS3 on *Business Combinations* (IASB, 2004). IFRS3, inter alia, confirms the general trend towards the capitalisation of goodwill and the use of impairment reviews. Clearly, there is considerable scope for assessing the impact of IASB changes upon the national standard setting agenda, which have not been addressed here.

6. The ‘measurement only’ stance to the accounting recognition of purchased goodwill and intangible assets has been heavily criticised in this thesis. That criticism is based on the inescapable logic of ‘asset recognition before asset measurement’ otherwise, one cannot be too sure of what one is measuring. As a result, the focus of this thesis has been directed towards asset recognition and not asset measurement. But, at the same time, no alternative asset recognition basis has been advanced that can address something which by nature is intangible. Further, even if some asset recognition basis other than or in addition to “transactions or events” was created, there would still be the unanswered question of the choice of measurement basis to accompany it. At the moment such concerns are avoided in

a mainly transactions-based system that simultaneously establishes asset recognition on the basis of an accurate measurement at a known point in time. However, these concerns can form the basis of a future research agenda, to be addressed in the section 7.7.

7. The references in respect of the revised Statement of Principles (ASB, 1999) are outside the consultation period relevant to this thesis, that is, 1993-1997, with the exception the original draft document (ASB, 1995b). Strictly speaking, any linkage between FRS10 (ASB,1997) and the Statement of Principles should be limited to the original draft, whereas, it was not so limited in this thesis. The reasons are twofold. First, the major difference between the original (ASB, 1995b) and the revision (ASB, 1999) highlighted by the respondents to original document was the belief that the economic focus of the Statement of Principles heralded in a change to current cost accounting. That belief was sufficiently broadly-based as to prompt the Board to issue a rebuttal presented in it's *The Way Ahead* document (ASB, 1996d) in the intervening period. That document emphasised the mixed measurement basis to accounting, which is within the relevant period referred to, above, and which is relevant to the focus of this thesis and the nature of purchased goodwill, in particular. Second, it is perhaps because of this misunderstanding[1], that the Board sought to support its revised Statement of Principles (ASB, 1999) with a 'technical

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[1] The offending passage referred to (ASB, 1995b, p93):

"The Board therefore believes that practice should develop by evolving in the direction of greater use of current values to the extent that this is consistent with the constraints of reliability and cost"

The word "reliability" should have been explicitly linked to a transactions basis. It was not so linked.

supplement' and some 'questions and answers'. As a result, the revised document, whilst smaller than the original document, was supported by a greater amount of supporting argument that was invaluable to the author in comprehending the Board's thinking on these matters. The thesis would have been the poorer in deliberately denying oneself access to these insights when the only material difference between the two documents lay in the above misunderstanding. As a consequence, wherever possible the referencing in chapters 4-7 has directed the reader to the original as well as the revised draft of the Statement of Principles (ASB, 1995b, 1999).

## **7.6. A discussion about the contribution of this thesis**

The research question was:

*How did the Accounting Standards Board resolve the conflicting views of the respondents to the Board's standard-setting consultation process prior to producing FRS10?. In particular, how did the Accounting Standards Board construct and perpetuate a portrayal of financial reality that currently includes 'purchased' goodwill and, at the same time, excludes many other intangible assets in opposition to those respondents who argued the case for their inclusion on the balance sheet?*

At the heart of this question is an assumption about the dominance of the Board in the construction and portrayal of financial reality and the power to enforce changes to it where appropriate. That construction and portrayal can accommodate a conceptual switch, per the signification structure, in goodwill 'non-asset status' to goodwill 'asset status', post-FRS10. In both cases: 'asset' and 'non-asset', can be portrayed as a true and fair portrayal of financial reality and audit-approved to that effect. However, if one subscribes to the view that the asset status of expenditures, once recognised, remains as a permanent feature of that 'asset' until it is sold or consumed, then the above switch should ideally be

grounded on a conceptually-based justification of the error that the profession made in either its pre or post-FRS10 construction of financial reality. 'Asset status' and 'non-asset status' are mutually exclusive terms, which means that where both are applied to the same purchased goodwill expenditures at two different periods of time, the resulting construction and portrayal of financial reality must have been erroneous for one of those periods of time. That said, there is no error if all that matters to you is that the construction and portrayal of financial reality should be grounded on nothing more profound than the exercise of preferences for one technical accounting method or another and the desire to be part of the same international consensus on goodwill as other national regulatory bodies. So, there is tension here between the first 'conceptual' viewpoint, above, and the second 'practical' viewpoint based on the exercise of preferences for accounting methods. We know from the analysis that the second viewpoint dominated but this does not explain how this tension was eliminated or reconciled or perpetuated by the Board in its construction and portrayal of financial reality concerning purchased goodwill and other intangible assets.

That was the reason for this thesis and the above research question. For example, what are the meaning or signification structures of accounting that enable the profession to accommodate the above 'error' without acknowledging that an error was even made. For example, how can the profession legitimate its position as society's primary financial information provider if it cannot accurately determine whether purchased goodwill is, by nature, an asset or not? – a fundamental 'asset or expense' recognition issue. Yet it does so, apparently, quite adequately. For example, how does the profession exercise its power to ensure (and enforce) that the above tension does not threaten the consistent practical application of whatever meaning or signification structure is currently in operation?. All



these points, and others, are subsidiary to the central research question but the important point is that they are integral to it. And that is the key feature of a structuration theory approach: it takes a holistic view of the structural ‘non-asset to asset’ change associated with FRS10 and examines it at the levels of meaning (signification), moral standing (legitimation) and the exercise of power (domination) respectively for each example, above, and others throughout the thesis.

There is no ‘tension’, above, if, to repeat, all that ultimately matters is that everyone adopts the same international approach to goodwill accounting. However, that domination-centred viewpoint tends to disconnect itself from the signification and legitimation structures of which it is an integral part. A structuration theory approach, to repeat, is an integrative approach whereby its tripartite structures inform the whole time and space location. From this integrative viewpoint there was a crisis of domination during the 1993-1997 period investigated in this thesis, which arose because:

*1. Signification.* The signification structure was taken for granted and yet, as the previous comments indicate, it should have been integral to the resolution of the purchased goodwill issue – the mixed measurement issue. Also, many of the respondents were well aware of the limitations on disclosure imposed by this structure, for example, in respect of the non-disclosure of many internally generated intangible assets. However, this structure was going to dominate regardless of such criticisms. To do otherwise would have been to broaden the debate so that it became potentially never-ending. A contribution of this thesis has therefore been to highlight the structural tensions that exist in accounting, to highlight that purchased goodwill is inextricably linked to those tensions and to highlight that any

longstanding resolution to the goodwill issue will probably be linked to a resolution of those structural tensions.

In pursuing the above ‘mixed measurement’ point further, purchased goodwill is, *by nature*, what it is defined to be: a “difference” of measurement. As well as permitting that definition to exist as a disclosed measurement the profession could cancel it instead, for example, by switching to the previously allowed merger/pooling-of-interests approach to business acquisitions or by adopting a single measurement basis to accounting in general. The existence of purchased goodwill is therefore permitted on the basis of another preference (a policy choice), that preference being for a more economically orientated view of the balance sheet that embraces fair values in excess of their original transaction-based costs, hence the allowed existence of differences of measurement. It is a ‘mixed measurement’ policy choice that results in “the accountant’s self-inflicted headache” (Baxter’s reference to purchased goodwill in ASB, 1995c, p16); a result of tying the above economic focus to one that is initially, and predominantly, grounded on transactions-based legalism, as supported by the definition of an asset (ASB, 1999, p50). The implication of this situation, and a contribution of this thesis, is that any permanent resolution to purchased goodwill issue is unlikely to be resolved in the long-term by the exercise of preferences for technical accounting methods and the building a dominant international coalition alone. Rather, any resolution will need to address the mixed measurement system of accounting as a whole and the determination of a single basis on which to measure any economic benefits. Further, it is a problem that will not go away because, as the longitudinal survey showed, purchased goodwill is set to dominate the balance sheet as the single largest amount on it.

2. *Legitimation*. It follows from point 1 that legitimating goodwill accounting practice against the *Statement of Principles* (from which the signification structure is drawn) is problematic. For example, had the definition of an asset, a-priori, been able to determine that goodwill was not an asset then the three capitalisation methods initially offered in the discussion paper would have been redundant from the outset. Instead, policy choices were exercised on the basis of preferences that were steered towards the current international norm of capitalisation and impairment reviews. Many of the respondents were unhappy about the rapid manner in which various accounting options were closed-down by the Board. However, that did not stop them from commenting on various conceptual issues long after there was closure on certain technical accounting methods. This allowed the author to structure the responses to the working paper in the same way as the responses to the earlier discussion paper but it also highlighted a more fundamental point – another contribution of this thesis. The point was that the respondents realised that a *dominant rationale* supporting the selection of an appropriate goodwill accounting method could only be built at the conceptual level of enquiry, whereas the Board appeared to be more interested in building a *dominant coalition* centred upon a technical level of enquiry (six accounting methods) and compliance with international norms.

3. *Domination*. The domination of policy choices contrary to the wishes of the majority of the consulted collectivity runs the risk of either being overturned by wholesale, non-compliant practice (an extreme and perhaps, unlikely occurrence) or, more likely, a reluctant acceptance of policy in practice but not in principle, as was evident from the responses to FRED12 and the selected comments about the US-led policy towards capitalisation and impairment reviews. What was evident from the analysis was that, on the basis of majority opinion, impairment reviews should have ‘died’ as a policy early on

in the consultation process. It survived because the Board wished to comply with the domination structure and was prepared to exercise power to that effect. That power was cleverly exercised by linking the supported ‘capitalisation and amortisation’ approach to the unsupported ‘capitalisation and impairment review’ approach in FRS10. One suspects that this was done in the foreknowledge of FRS11 (ASB, 1998) and the international developments that were leading up to the implementation of IFRS3 (IASB, 2004). A contribution of this thesis was therefore to highlight the power characteristics of this situation, a situation which undermined an important aspect on which the legitimacy of the profession rests: bringing the accounting collectivity ‘on-board’ in the Board’s regulatory construction of financial reality.

#### **7.7. The direction of future research**

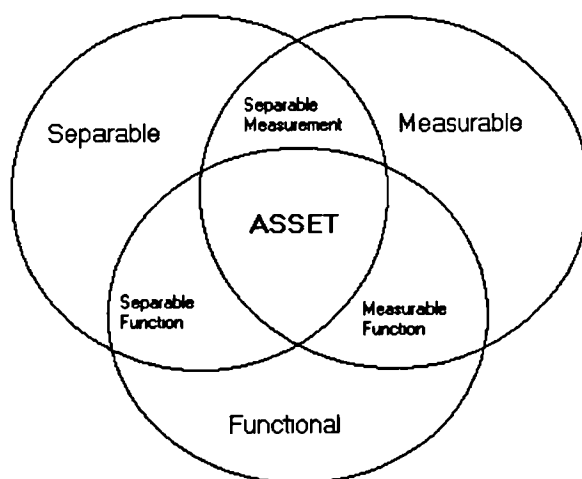
Section 7.6 leads to the conclusion that the ‘measurement only’ focus of the definition of an asset does not permit the recognition of the nature of an asset, including the problematic intangible ones such as goodwill. Thus, future research should be directed towards this issue, in particular, that since asset recognition is a-priori to asset measurement, asset recognition should be on the basis of criteria that distinguish an asset from an expense other than on the current basis of the discretion exercised by accounting actors. In effect, to construct a new signification structure in which the interpretive scheme is not initially grounded on the reliability of transactions-based asset measurement but upon the reliability of asset recognition criteria.

In contrast, an often quoted and humorous analogy used to refute the need to identify an intangible asset, legally or otherwise, is that if a thing has some of the characteristics of a dog, for instance, it barks like a dog, then it must be a dog. One does not need to see or

physically touch it to be able to recognise it as a dog! However, this is a far from satisfactory way of recognising a dog, let alone the type of dog. What is required are more precise criteria so that the separable recognition of a dog cannot be confused, say, with the separable recognition of a wolf. Worst still, what if it turned out to be a man-made recording of a dog and there was no resource at all. One cannot imagine, for example, the medical profession adopting a similar stance: the illness has some of the characteristics of influenza but then it turns out to be meningitis! The medical profession is able to support operational criteria for the diagnosis of illnesses through scientific testing, however, as this thesis shows, in the accounting profession such procedures are less well articulated.

Asset recognition criteria may be categorised as being part of an asset's separable function, separable measurement or measurable function, per Figure 7.9:

Figure 7.9: The Essential Characteristics of an Asset



The examination of the existing signification structure, Figure 5.1(a)&(b), revealed that the structure, and within it, the definition of an asset is measurement focused. The central reliance on transactions produced a measurement, usually at cost, that simultaneously established its recognition as an asset. However, all this does in respect of Figure 7.9 is

establish a separable measurement. Thus, for example, purchased goodwill has a separable measurement from the other assets of a business and is now recognisable as an asset for accounting purposes. However, purchased goodwill does not have a separable function from the other assets of a business, nor can it have a measurable function unless the defined “difference” that constitutes its nature is explained first. Comparatively, an intangible asset, such as a ‘strategic location’, may possess a measurable function. That is, the location may be capable of producing wealth for which some attempt may be made to establish a separable measurement, for example, transport cost savings, but establishing a separable function capable of transference independently of the land to which it would be attached would be impossible. Also, whether a separable measurement in this regard should be expressed in terms of opportunity cost savings depends on the chosen framework for measurement. At the moment this is expressed in the existing signification structure on a multiple mixed measurement basis. The point, however, is that various aspects of the interplay in the classifications presented in Figure 7.9 should be examined in any future research and tested in relation to various intangible assets.

A fundamental feature of separability is the idea that an asset is transferable between parties. It follows that separability is compatible with a transaction basis to accounting because it too usually involves the transference of goods and services, for example, all purchases and sales. However, separability would also embrace non-transaction-based assets, such as internally generated intangible assets, that were capable of transference, typically, those supported by an artefact.

Some work on classifications (Gröjer, 2001), such as that presented in Figure 7.9, also, asset recognition criteria (Honoré (1961) has already been done and used (Pallot, 1990;

Mautz, 1988). It was also interesting to note that some of the respondents to the FRS10 consultation process attempted to create some recognition criteria of their own, as presented in Figure 7.10. In all three cases separability was a key criterion and they all related to the recognition of brands.

**Figure 7.10 Asset recognition criteria proposed by the respondents**

Cadbury Schweppes Plc (ASB, 1994a, p82) advocate the following criteria:

“long term and substantial;  
subject to clear and continuing title;  
having a separately identifiable earnings stream; and  
capable of disposal separately from the rest of the business.”

The CBI (ASB, 1994a, p103) adopt similar intangible asset recognition criteria:

“long term and substantial,  
capable of separate identification apart from the underlying business  
whether the historical acquisition can be identified with reasonable certainty as part of the  
fair value exercise on acquisitions.”

Guinness Plc (ASB, 1994a, p169) support the Arthur Andersen claim that brand valuation methodologies are systematic and well advanced and they propose the following recognition criteria for the inclusion of brands on the balance sheet:

“subject to clear and continuing title  
long term and substantial  
generating a separately identifiable earning stream  
capable of disposal separately from the rest of the business and  
(in the case of consumer brands) achieving earnings in excess of unbranded products.”

If a separable measurement is to be made for an individual asset possessing separable function, then a key feature here is breaking the link between purchased goodwill and any intangible asset supposedly subsumed within it. For example, within the existing signification structure a brand may be capitalised on the basis of a valuation extracted from the transactions-based cost of acquiring goodwill, and, in that context alone as far as actual practice is concerned. In other words, one separable measurement is extracted from another separable measurement. The linkage is therefore entirely measurement focused (hence, it is compliant with the existing signification structure) rather than focused on their respective separable functions or whether there is a measurable function (per any additional/replacement signification structure). Yet, in terms of ‘function’ there are no

other assets that the author can think of where the existence of one asset, a brand, is so heavily dependent on the existence of another asset(?), purchased goodwill. The same logic would also be applicable to any other intangible asset supposedly hiding within purchased goodwill. Whilst the author would argue that this linkage is tenuous, as far as the FRS10 respondents were concerned, there were those who argued:

*(a) the case for the continued subsumption of intangible assets within purchased goodwill*

– *Figure 7.11.*,

**Figure 7.11. Comments in favour of subsuming intangible assets within goodwill**

“The Institute agrees that purchased intangible assets should be subsumed within purchased goodwill and accounted for accordingly. The Institute considers that it is often difficult to allocate separate values to individual cases within a business. Even if it were possible, the institute doubts whether such an exercise could add much (or any) value or insight. Indeed, the idea of separation seems unable to provide any assistance with the problem of goodwill accounting” IIMR (ASB, 1994a, p212).

“We agree with ASB’s proposal that purchased intangible assets should be subsumed into goodwill and treated as such in the accounts. We recognise that this proposal is likely to be opposed by companies which own brands, but we feel that so long as internally generated brands are not recognised it would be inconsistent to recognise purchased brands” IFMA (ASB, 1994a, p215).

*(b) those who argued for their extraction from purchased goodwill citing the reliability of valuations and the need for codification as a justification for such practices – Figure 7.12.*,

**Figure 7.12 Comments in favour of the separable disclosure of intangible assets**

“UK business is increasingly interested in the exploitation of intangibles, it is wrong to try to turn back the clock by denying their recognition in financial statements” Cooper & Lybrand (ASB, 1994a, p106).

“...intangible assets are constantly traded and are just as definable and in many cases more capable of specific valuation than tangible assets. I further question the irrational view that goodwill is a bucket into which one tosses assets beyond the bookkeeper’s comprehension. If you wish to recognise reality I suggest you start again by dealing only with Intangible Asset and how they should be accounted for. Subsequently, the goodwill debate will disappear as irrelevant. The US authorities accept the reality argument and have clear methodologies which are acceptable to the IRS on which tax allowances are given” James (ASB, 1994a, p247).

“...almost all purchased intangible assets will be subsumed within goodwill on the basis that it is



impossible to measure the value of these assets reliably. We do not agree. We appreciate the difficulties in valuing intangible assets but do not believe that this should prevent recognition where such assets are purchased as part of a package in acquiring a business” KPMG (ASB, 1994a, p253).

“A central element in the proposed approach on intangibles is the belief that goodwill cannot be disposed of without disposing of the business of the related undertaking. We do not argue with this general proposition but we think that a range of intangibles can be distinguished by reference to the guiding principles of separability and measurement: in particular Stock Exchange seats, brands, publishing titles and newspaper mastheads can be – and are – sold separately. We believe, therefore, that there are no strong arguments for a regime which would require “standard goodwill treatment” in the case of intangibles that can be transferred separately” BMBA (ASB, 1994a,p70).

(c) *those who argued the author’s position that intangible assets and purchased goodwill are two entirely separate and unconnected issues – Figure 7.13.*

**Figure 7.13. Goodwill and Intangible Assets as two separate issues**

“We think that goodwill and intangible assets should not be dealt with in the same standard, and that the rules for intangibles should not be based on those devised for goodwill. Goodwill poses particular accounting problems because of its nebulous nature, but this is true of only a few other intangibles that are close to goodwill. Many intangible assets have more in common with tangible assets than with goodwill, in that they are the result of separate expenditures, not incidental to an acquisition, and they are sufficiently separate from the generality of the business for their useful lives to be assessed in a meaningful way. Examples include music-publishing rights, airport landing slots, patent rights etc. While we recognise the need to avoid the risk of ‘accounting arbitrage’- side stepping the rules for goodwill by defining the asset as another kind of intangible – this does not justify forcing all intangibles into a mould designed for goodwill” Ernst & Young (ASB, 1995c, p109).

“...remain of the opinion that accounting for intangible assets and accounting for goodwill need not be linked. We believe that the concern set out in the paper that failure to link the subjects creates an opportunity for accounting arbitrage is one that can be addressed in other ways. Specifically, if it is accepted, as we strongly believe, that there are well established and reliable methods for valuing intangible assets acquired by the purchase of a company or business that owns them then reperforming that valuation methodology regularly will ensure charges to profit for diminutions in value are not avoided” Guinness Plc (ASB, 1995c, p165).

“Goodwill is in effect the residual intangible asset and has characteristics separate from other intangible assets. The rules developed in relation to intangible assets should not therefore in our view be applied to goodwill without modification. Hence goodwill should be the subject of a separate standard” The Institute of Chartered Accountants in Ireland (ASB, 1995c, p190).

“...feel strongly that any attempt to subsume intangibles in “goodwill” is nothing less than a “cop out”...As you are aware brands are the particular intangibles that concern Cadbury Schweppes and the major part of our business effort is directed at maximising the value that can be gained from such assets, even though the manufacture, distribution and selling of the final product is in the hands of third parties...We consider that such intangibles can be identified, are separable, can be legally controlled (via trademarks) and can be valued using well tried techniques which were outlined in The Economist publication “The Valuation of Intangible Assets” by Arthur Andersen” Cadbury Schweppes Plc (ASB, 1995c, p37).

Those advocating (a), being entirely transactions-based, fits within the existing signification structure. In support, the Board’s view was that because many intangible

assets shared the same characteristics as goodwill, brands and newspaper titles and mastheads should be treated as part of goodwill (see ASB, 1993, p17). Those advocating (b) allow for a degree of flexibility in the use of valuations within a total known transactions-based measurement but overall remain within the existing signification structure. Advocates of (c) allow for the possibility of the separable recognition of intangible assets either within the existing signification structure where purchased or as an extension to it where valued independently from purchased goodwill. It is in respect of (c) that further research analysis is required.

Turning now to the issue of legitimation, those who would legitimate their role in society by reference to the persona of professionalism are inevitably attracted to the idea that they are able to offer objective information derived from an objective conceptual foundation to their knowledge – objective by nature, objective in practice. It is a strategy that would naturally present practical inadequacies in terms of technical inadequacies rather than conceptual inadequacies because to do otherwise would undermine the foundations of accounting itself. (Perhaps, this accounts for the presentation of six *technical* accounting methods in the discussion paper?). As such, an alternative signification structure is unlikely to receive serious attention because, by implication, it points to an epistemological foundation that is incomplete or, perhaps, even flawed. So, the above alternative signification structure based use of ‘asset recognition criteria’ has already been rejected by the Board (ASB, 1999, paraB4.2). It follows that the norms of behaviour and social action, which are largely supportive of the existing accounting structures, are unlikely to legitimate alternatives to the status quo.

That said, an alternative legitimization structure could be centred on the inadequacies of the existing norms of behaviour. Two aspects could be explored: first, that in legitimating against a conceptual framework the profession is embracing subjective socio-political policy choices which, of course, can be changed if there is the political will to do so. Second, there are many examples where a company can ‘bend the accounting rules’ within the existing signification structure and yet, legitimately, still comply with the existing accounting norms of behaviour, particularly, where such social action passes audit scrutiny. There are many supporting examples from the longitudinal survey in that regard. In both cases, the argument is that if there are inadequacies, then the Board may wish to consider an alternative social structure, such as that presented in Figure 7.9.

Finally, turning to the issue of domination. Clearly, the power to direct change resides with the Board. That said, this thesis shows that consulting the accounting collectivity on the technical form of goodwill accounting and selectively overriding their majority viewpoints is a problematic basis on which to ground purchased goodwill’s newly found asset status. What is required is a conceptual approach that embraces fundamental issues concerning the nature of assets in a changing economic reality where intangible assets are of equal importance to their tangible counterparts.

## Appendix A: A longitudinal survey

A longitudinal survey of purchased goodwill and intangible asset accounting practices for the period 1993–2002 is presented, that is five years pre-FRS10 and five years post-FRS10 (ASB, 1997). The purpose is two-fold, first, to show that compliance with FRS10 was complete and, second, to assess the impact on the asset base of the surveyed companies had purchased goodwill been capitalised over the ten year period instead of mainly being written off to reserves, pre-FRS10. The reason for this latter assessment is to show that the switch from the dominant elimination-based accounting method, pre-FRS10, to asset-based methods, post FRS10, removes one problem, reserve depletion, and potentially replaces it with another: the dominance of goodwill ‘assets’ on UK balance sheets.

The survey comprised a static sample of the top 227 UK Plc’s by turnover according to the *Times 1000* list of companies for 1993. As a static sample it has, nevertheless, been declining over the years mainly because of company takeovers. The choice of a turnover basis rather than a capital basis to the survey was prompted by the desire in 1993 to investigate brand accounting practices, the survey sample comprising all those brand accounting companies who sponsored the Arthur Andersen report into *The Valuation of Intangible Assets*, a year earlier. As a result, many capital-intensive businesses, such as the banking and finance sector, are excluded from the survey sample presented in table 6.9:

Table 6.9: Survey company groupings (number of companies 1993)			
Alcoholic Beverages	3	Health Care	4
Breweries, Pubs & Restaurants	4	Household Goods	5
Building Materials and Merchants	17	Insurance	2
Chemicals	8	Leisure and Hotels	7
Construction	11	Media	12
Distributors	10	Oil	5
Diversified Industries	5	Paper, Packing and Printing	5
Electricity and Gas	18	Pharmaceuticals	4
Electronics and Electrical Equipment	8	Support Services	8
Engineering	34	Telecommunications	4
Extractive Industries	2	Tobacco	2
Food Producers	13	Transport	7
Food Retailers	7	Water	6
General Retailers	16	Total	227

Table 6.10 shows the change in the number of public limited liability companies within the survey sample since 1993:

Table 6.10	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Opening balance	227	227	225	222	210	200	191	176	159	148
Takeovers & Mergers	-	(1)	(2)	(11)	(9)	(9)	(14)	(16)	(9)	(6)
Delisted companies	-	(1)	(1)	(1)	(1)	(2)	(1)	(1)	(2)	(3)
Closing balance	227	225	222	210	200	191	176	159	148	139

Table 6.11 summarises the number of individual disclosures of purchased goodwill and intangible assets on the surveyed company balance sheets.

<b>Table 6.11</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Intangibles (generic)	9	9	9	9	9	10	10	10	10	10
Goodwill	5	7	7	5	6	80	132	132	124	123
Brands/Trademarks	8	9	10	10	10	8	6	7	8	9
Copyright	7	8	8	7	7	5	7	6	6	6
Licence/Concessions	5	4	3	3	3	4	3	7	10	8
Patents	2	2	2	2	2	2	2	1	1	1
Software	2	2	2	2	4	4	2	3	2	1
Development	9	6	5	4	3	3	5	4	3	3
Exploration	6	6	6	6	6	6	6	5	4	4
<b>Total</b>	<b>53</b>	<b>53</b>	<b>52</b>	<b>48</b>	<b>50</b>	<b>122</b>	<b>173</b>	<b>175</b>	<b>168</b>	<b>165</b>

The 'Intangibles (generic)' figures relate to those companies who do not separately identify intangible assets. For example, this would include Boots Plc who capitalise trademarks but the figure cannot be separated from the other disclosed intangible assets. Table three can be translated into monetary terms (£million) in table 6.12:

<b>Table 6.12 (£m)</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Intangibles (generic)	426	431	394	393	447	1894	1918	985	683	614
Goodwill	113	1541	1506	1321	1483	12191	40915	113407	194502	172274
Brands/Trademarks	6431	7686	9992	9659	9306	8797	9287	11432	16003	15882
Copyright	4794	5209	5123	3873	4061	2260	3728	4671	6076	5672
Licence/Concessions	542	578	435	496	948	693	596	1249	25037	15550
Patents	62	105	98	122	165	233	289	334	4	4
Software	121	142	157	152	270	579	156	271	189	198
Development	97	65	44	33	29	80	70	69	111	109
Exploration	1382	1199	1279	1287	1433	2246	2452	4220	4249	5344
<b>Total</b>	<b>13847</b>	<b>16956</b>	<b>19028</b>	<b>17337</b>	<b>18142</b>	<b>28983</b>	<b>59411</b>	<b>136638</b>	<b>246854</b>	<b>215667</b>

The substantial increase in the Licence/Concessions figure in 2001 relates to British Telecommunications Plc and Vodafone Plc. The substantial increase in the goodwill figures from 1998 onwards relates to the implementation of FRS10. Prior to 1998 the capitalisation of purchased goodwill was a minority optional method allowed under SSAP22 (ASC, revised 1989).

There is merit in analysing the 'Brands/Trademarks' heading in table 6.12, first, as a way of showing how the summary information may be decomposed, second, because this particular heading always occurs as an extraction from the goodwill arising from a business acquisition. As such, brands/trademarks should be added back to any purchased goodwill for the purpose of assessing the overall effect of purchased goodwill on the asset base of the surveyed companies. With the exception of Reuters Plc in table 6.13, brands were retained without amortisation, subject to an annual impairment review.

<b>Table 6.13</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
<b>Brands/Trademarks</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Cadbury Schweppes Plc	446	522	1689	1547	1575	1561	1656	2354	2764	2764
Grand Metropolitan Plc*	2924	2782	3840	3884	-	-	-	-	-	-
Guinness Plc *	1395	1395	1395	1395	-	-	-	-	-	-
Diageo Plc (*merger)					4995	4727	4875	4875	5213	5307
Ladbroke Plc <sup>1</sup>	377	277	277	277	277	277	277	277	277	277
London International Plc	40	40	36	32	32	32	-	-	-	-
Reckitt & Colman Plc <sup>2</sup>	682	1296	1273	1145	1135	1187	1489	1584	1701	1633
United Biscuits Plc	217	248	251	211	138	-	-	-	-	-
WPP Plc	350	350	350	350	350	350	350	950	950	950
SmithKlineBeecham Plc <sup>3</sup>		776	751	688	652	644	640	632	1241	1140
Dalgety Plc			130	130	130	-	-	-	-	-
Inchcape Plc					22	19	-	-	-	-
Unilever Plc (Euro to £)								760	3825	3225
Reuters Plc									32	31
Allied Domecq Plc										555
<b>Totals</b>	<b>6431</b>	<b>7686</b>	<b>9992</b>	<b>9659</b>	<b>9306</b>	<b>8797</b>	<b>9287</b>	<b>11432</b>	<b>16003</b>	<b>15882</b>
<b>Number of Companies</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>8</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>

<sup>1</sup> Now Hilton Group Plc    <sup>2</sup> Now Reckitt Benckiser Plc

<sup>3</sup> Now GlaxoSmithKline Plc

Despite a regulatory requirement to disclose the cumulative goodwill written-off to reserves, some companies did not disclose this figure. Table 6.14 indicates the extent of cumulative purchased goodwill disclosure within the survey sample.

<b>Table 6.14</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Number of companies reporting cumulative goodwill	197	198	198	189	181	169	152	132	122	116
Total number of companies	227	225	222	210	200	191	176	159	148	139
% of companies reporting cumulative goodwill	87%	88%	89%	90%	90%	89%	86%	83%	82%	83%
Cumulative goodwill written-off to reserves (£bn)	72.43	78.31	96.13	101.8	113.5	105.2	94.90	80.02	77.39	70.55
Average cumulative goodwill written-off (£bn) per goodwill reporting company	0.368	0.396	0.486	0.539	0.627	0.623	0.624	0.606	0.634	0.608
Total Net Assets (£bn)	446.8	454.6	476.8	466.1	447.3	429.4	483.4	694.3	701.0	734.0
Av. Total Net Assets (£bn) per company	1.968	2.021	2.148	2.220	2.236	2.248	2.747	4.367	4.736	5.281
Average cumulative goodwill / Average Total Net Assets %	18.7 %	19.6 %	22.6 %	24.3 %	28.0 %	27.7 %	22.7 %	13.8 %	13.4 %	11.5 %

Table 6.14 has to be used with considerable caution, particularly in respect of that information which is not disclosed by companies. For example, FKI Plc in their 2001 annual report state that there is “insufficient information” to calculate the figure in the respect of certain previous group reorganisations prior to 1989. In contrast, some companies, such as Wolseley Plc, were able to capitalise all purchased goodwill previously written-off to reserves back to 1958. Many companies appear to have an arbitrary starting

point, typically starting in the 1980's. The point here is that one is not strictly comparing like with like and one has to rely upon year on year consistency in cumulative goodwill reporting (82% min. to 90% max. of sample size over the ten years) and the overall trend in any analysis. In this latter regard the figures are, perhaps, better presented as annual averages as expressed in the bottom line percentages in table 6.14.

Looking at the bottom line in table 6.14 one can see that the year-on-year percentage increase peaks in 1997. In that year there were eight companies who disclosed a negative 'capital and reserves' figure on the balance because of the depleting effect of goodwill write-offs on reserve balances (technically, insolvent companies). Post FRS10, purchased goodwill is no longer to be written-off to reserves, so these percentages will decline as total net assets are swelled by capitalised goodwill and the goodwill on disposals is written back year-on-year to the profit and loss account.

Turning now to the introductory objective, there are two ways one might assess the impact on the asset base of the surveyed companies had purchased goodwill been capitalised over the ten year period. The first way, presented in table 6.15, is to maintain the reported cumulative goodwill write-off figure post-FRS10 and then divide the resultant figure by the total net assets for all surveyed companies. The second way presented in table 6.16, would be to account for the individual pre-FRS10 goodwill write-offs as if they had been capitalised and then divide the resultant figure by the total net assets for all surveyed companies.

Selected information from tables 6.13 and 6.14 can be used in table 6.15 to redraft the bottom line 'Av. Cumulative Goodwill to Av. Total Net Assets' percentages first shown in table 6.14. Table 6.15 shows the effect on total net assets of writing-off all goodwill and brands over the ten-year period as if FRS10 had not happened and all companies had continued to adopt the dominant reserve write-off approach under SSAP22. As one would expect the percentage figures for the first five years to 1997 are similar between tables 6.14 and 6.15. Thereafter, the percentages diverge as table 6.15 excludes the impact of FRS10.

In table 6.15, the substantial percentage rise in 2001 relates to the Vodafone Plc takeover of Mannesmann AG comprising £83bn in purchased goodwill (82% of acquired asset values).

<b>Table 6.15 (£bn)</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Cumulative goodwill write-off to reserves	72.43	78.31	96.13	101.8	113.5	105.2	94.90	80.02	77.39	70.55
Add brand assets	6.43	7.69	9.92	9.66	9.31	8.80	9.29	11.43	16.00	15.88
Add goodwill assets	0.11	1.54	1.51	1.32	1.48	12.19	40.92	113.4	194.5	172.3
Sub total (rounded)	79.00	87.5	107.6	112.8	124.3	126.2	145.1	204.9	287.9	258.7
Number of companies reporting cumulative goodwill	197	198	198	189	181	169	152	132	122	116
Av. cumulative write-off per company	0.401	0.442	0.543	0.597	0.687	0.747	0.955	1.552	2.360	2.23
Total Net Assets	446.8	454.6	476.8	466.1	447.3	429.4	483.4	694.3	701.0	734.0
Less brand assets	6.43	7.69	9.92	9.66	9.31	8.80	9.29	11.43	16.00	15.88
Less goodwill assets	0.11	1.54	1.51	1.32	1.48	12.19	40.92	113.4	194.5	172.3
Sub total (rounded)	440.3	445.4	465.4	455.1	436.5	408.4	433.2	569.5	490.5	545.8
Total number of companies	227	225	222	210	200	191	176	159	148	139

Av. total net assets per company	1.939	1.979	2.096	2.167	2.183	2.138	2.461	3.582	3.314	3.927
Average cumulative goodwill / Average Total Net Assets %	20.7 %	22.3 %	25.9 %	27.5 %	31.5 %	34.9 %	38.8 %	43.3 %	71.2 %	56.8 %

The second way one might assess the impact of purchased goodwill on the asset base of the surveyed companies is to account for the individual pre-FRS10 goodwill write-offs as if they had been capitalised, instead:

<b>Table 6.16 (£bn)</b>	<b>1993</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Goodwill write-offs	8.25	8.92	20.07	13.97	17.67	8.99	-	-	-	-
Add brand assets	6.43	7.69	9.92	9.66	9.31	8.80	9.29	11.43	16.00	15.88
Add goodwill assets	0.11	1.54	1.51	1.32	1.48	12.19	40.92	113.4	194.5	172.3
Sub total (rounded)	14.8	18.2	31.5	25.0	28.5	29.9	50.2	124.8	210.5	188.2
No. of goodwill write-off and g'will asset reporting companies	164	159	160	147	147	138	132	132	124	123
Av. cumulative goodwill asset per company	0.090	0.114	0.197	0.170	0.194	0.217	0.380	0.945	1.698	1.530
Total Net Assets	446.8	454.6	476.8	466.1	447.3	429.4	483.4	694.3	701.0	734.0
Add goodwill write-offs	8.25	8.92	20.07	13.97	17.67	8.99	-	-	-	-
Sub total (rounded)	455.1	463.5	496.9	480.1	465.0	438.4	483.4	694.3	701.0	734.0
Total number of companies	227	225	222	210	200	191	176	159	148	139
Av. total net assets per company	2.005	2.06	2.238	2.286	2.325	2.295	2.747	4.367	4.736	5.281
Average goodwill / Average Total Net Assets %	4.50 %	5.53 %	8.80 %	7.44 %	8.34 %	9.45 %	13.8 %	21.6 %	35.8 %	29.0 %

There are no goodwill write-offs from 1999 onwards, compliance with FRS10 being complete. The 'Goodwill write-offs' figures in table 6.16 have been adjusted to 95% of the disclosed values in the reserve note to company balance sheets on the assumption that all companies would have amortised over 20 years. Whilst all surveyed companies amortised purchased goodwill immediately post FRS10, of course, amortisation could have occurred over a shorter period than 20 years.

Again, one can observe the effect of the Vodafone Plc takeover in 2001 in the 'goodwill assets' figure.

#### **A concluding comment**

The bottom line percentages in table 6.16 are obviously lower than in respect of table 6.15 because of the exclusion of cumulative goodwill arising from a period prior to 1993. However, the trend in the 'average goodwill / average total net assets' ratio, whether cumulative (table 6.15) or not (table 6.16), is increasing in both cases. It is perhaps, too soon to state categorically that goodwill will come to dominate the balance sheet but the above tables certainly point to that likelihood in the future.



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